Petition

81-815

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No.

IN THE

Supreme Court of the United States

October Term, 1981

JOSEPH E. SHAMY,

Petitioner,

v.

UNITED STATES OF AMERICA.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the court of appeals, consistent with the Fifth Amendment's guarantee of due process of law and this Court's decisions in *Dunn* v. *United States*, 442 U.S. 100 (1979), and *Cole* v. *Arkansas*, 333 U.S. 196 (1948), can affirm a defendant's conviction on an entirely different legal theory than that upon which the district court permitted him to be tried, without affording the defendant a new trial in which he can present a defense based upon the appellate court's interpretation of the law.

2. Whether a defendant, who was a lawyer for and employee of a corporation, can be convicted under federal mail and wire fraud statutes for engaging in a "scheme to defraud" alleged to violate common law concepts of "uprightness, fundamental honesty, fair play and right dealings" for fiduciaries, where the contracts under which he received all of the proceeds of the alleged scheme were valid under a state statute that specifically regulated the contractual dealings between a corporation and its related parties.

3. Whether the prosecution violated petitioner's Fifth Amendment privilege against self-incrimination by using his statements made to state-appointed auditors, who were simultaneously serving as the company's private accountants, where the statements were made after the accountants, at the state's instruction, began cooperating with the F.B.I. in its investigation of petitioner's financial dealings.

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OPINIONS BELOW

The judgment of conviction of the United States District Court for the District of Maryland, dated April 3, 1980, appears as Appendix F, pp. 47a-48a, *infra*. The district court's order and opinion denying petitioner's motion for judgment of acquittal, dated March 17 and 21, 1980, respectively, appear as Appendices D and E, pp. 31a-45a, *infra*. The district court's order and opinion denying petitioner's motion for judgment of acquittal at the conclusion of the government's case-in-chief, dated December 5, 1979, appears as Appendix C, pp. 21a-30a, *infra*. None of the district court orders or opinions is published. The orders and opinions of the United States Court of Appeals for the Fourth Circuit, dated August 13, 1981 and September 25, 1981, which affirmed petitioner's conviction and denied his request for rehearing, appear as Ap-

pendices A and B, pp. 1a-19a, *infra*, and are also not reported.

JURISDICTION

The order of the United States Court of Appeals for the Fourth Circuit, affirming petitioner's conviction, was rendered on August 13, 1981 (p. 1a, *infra*). A timely petition for rehearing and suggestion for rehearing *en banc* was denied on September 25, 1981 (p. 19a, *infra*). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Fifth Amendment:

> No person . . . shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law . . . .

Md. Ann. Code, Corp. & Ass'n. § 2-419:

> (a) *General rule* — If subsection (b) is complied with, a contract or other transaction between a corporation and any of its directors or between a corporation and other corporation, firm, or entity in which any of its directors is a director or has a material financial interest is not void or voidable solely because of any one or more of the following:
>
> (1) The common directorship or interest;
>
> (2) The presence of the director at the meeting of the board or a committee of the board which authorizes, approves, or ratifies the contract or transaction; or

(3) The counting of the vote of the director for the authorization, approval, or ratification of the contract or transaction.

(b) *Disclosure and ratification* – Subsection (a) of this section applies if:

(1) The fact of the common directorship or interest is disclosed or known to:

(i) The board of directors or the committee, and the board or committee authorizes, approves, or ratifies the contract or transaction by the affirmative vote of a majority of disinterested directors, even if the disinterested directors constitute less than a quorum; or

(ii) The stockholders entitled to vote, and the contract or transaction is authorized, approved, or ratified by a majority of the votes cast by the stockholders entitled to vote other than the votes of shares owned of record or beneficially by the interested director or corporation, firm, or other entity; or

(2) The contract or transaction is fair and reasonable to the corporation.

(c) *Counting common or interested directors in determining quorum* – Common or interested directors or the stock owned by them or by an interested corporation, firm, or other entity may be counted in determining the presence of a quorum at a meeting of the board of directors or a committee of the board or at a meeting of the stockholders, as the case may be, at which the contract or transaction is authorized, approved, or ratified.

(d) *Burden of proof; fixing of compensation* – (1) If a contract or transaction is not

authorized, approved, or ratified in one of the ways provided for in subsection (b)(1) of this section, the person asserting the validity of the contract or transaction bears the burden of proving that the contract or transaction was fair and reasonable to the corporation at the time it was authorized, approved, or ratified.

(2) This subsection does not apply to the fixing by the board of directors of reasonable compensation for a director, whether as a director or in any other capacity.

STATEMENT

Petitioner was convicted after a trial by jury on seven counts of a 13-count indictment (six of the counts having been dismissed by the district court) charging him with mail fraud, wire fraud, and racketeering in violation of 18 U.S.C. §§ 1341, 1343 and 1962. After considering a motion for judgment of acquittal for more than a month and advising that he had "great doubt about this verdict . . . as a matter of law, as to whether it ought to stand or not in certain areas" (Tr. Feb. 15, 1981, 33), the district judge (Miller, J.) denied the motion and sentenced petitioner to concurrent four-year terms of imprisionment and imposed a fine of $31,000. The court of appeals affirmed petitioner's conviction, rejecting the district judge's mid-trial rulings as to the aplicable law (which was central to petition's defense) and concluding that petitioner could be convicted of federal mail fraud irrespective of the legality of his conduct under state law, if he acted in a manner which was contrary to "accepted standards of moral uprightness, fundamental honesty, fair play and right dealing" (p. 13a, *infra*). The court of appeals characterized the case as an instance of a "faithless servant who covertly enriched himself at the expense of the corporation to

which he owed his loyalty" (p. 17a, *infra*). Even though the case had been presented to the jury on the understanding that certain provisions of Maryland law were applicable and controlling, the court of appeals ignored petitioner's defense that his acts were lawful under these provisions of the state's corporations law because the transactions were "fair and reasonable" and were approved by the company's directors.

1. Overview

Petitioner was a practicing attorney who, in 1975, together with two clients, purchased a controlling interest in the Laurel Harness Racing Association, a corporation which owned and operated a run-down racetrack in Laurel, Maryland. Petitioner's interest was subsequently sold to another individual, and in February, 1976, petitioner's father-in-law purchased the controlling interest in the corporation. The father-in-law, petitioner's wife, and petitioner's sister thereafter comprised the corporation's board of directors. At various times petitioner served as general counsel and administrator for the corporation, and as the contractor for the total reconstruction of the racetrack. The latter capacity was one which petitioner, until the project was completed, concealed from the corporation's minority stockholders and a state-appointed auditor. The prosecution's case against petitioner related to financial transactions concerning the reconstruction of the racetrack facility between July 1976 and September 1978. In particular, the prosecution claimed that petitioner, as a fiduciary of the corporation, defrauded the minority stockholders by partially concealing the profit he made on the construction contracts pursuant to which petitioner agreed to renovate the entire racing facility for a fixed price of $3.68 million.

2. Petitioner's Dealings with the Corporation

Shortly after petitioner's father-in-law acquired the majority interest in Laurel, the Maryland Racing Commission directed that unless the corporation completely refurbished the track, clubhouse and support facilities within one year, Laurel's allotment of racing days would be withdrawn. Because of then recent prosecutions of Maryland political figures in connection with the racing industry, and generally prevailing depressed economic conditions, the corporation could not obtain the several million dollars of construction financing required for the renovation. Without guaranteed financing, no independent contractor would undertake the project. Facing the Commission's ultimatum to rebuild, and with no general contractor available, Laurel's board requested petitioner, who had general contracting experience, to do the project. Thereafter, petitioner, under a sole proprietorship, Howard Construction Co., entered into three fixed-priced contracts with Laurel covering all phases of the renovation. The entire project was completed on schedule, leaving the corporation with a first-class facility, including one of the finest racing surfaces on the East Coast. According to the prosecution's evidence, petitioner's hard costs for the project totalled approximately $2.4 million, leaving him a profit and overhead figure of about $1.2 million.

3. The Audits and Investigation

As a licensee of the state Commission, Laurel was required by statute to retain a Commission-approved certified public accounting firm to publish an annual audited financial statement. Md. Ann. Code art. 78B § 13. At the time of the audit for fiscal 1976, Laurel had signed con-

tracts with Howard Construction and made initial payments totaling $325,000. As the auditors began their review they were told by another accountant that Howard Construction was an enterprise of petitioner and that he had so stated on bank account signature cards. The auditors asked petitioner whether he had a relationship with Howard, to which he responded only that he served as counsel to the company. Although the auditors considered this response inconsistent with the information they already had, they concluded that petitioner's answer was enough to require footnote disclosure reflecting that petitioner had a conflicting interest in both entities. The conflict was thus disclosed in the 1976 financial statements.

The next fiscal year — with the renovations completed and permanent financing available — petitioner informed the auditors that he actually owned Howard Construction. With this information the accountants began a related-parties audit of both Laurel and Howard Construction. Shortly before the audits got underway, however, F.B.I. agents contacted the accountants, informing them that the F.B.I. was interested in petitioner's financial activities. Although the auditors prepared Laurel's tax returns and performed other accountant-client functions for Laurel independent of the state-required audit, they did not mention the F.B.I.'s visit to anyone affiliated with Laurel, but instead solicited and obtained a directive from the Commission and the Maryland State Attorney General's Office to cooperate in the F.B.I.'s investigation. The auditors never obtained the permission of anyone at Laurel to release confidential client information, nor informed anyone at Laurel that they were doing so. They ultimately turned over all of their work papers for use in the prosecution after a subpoena — which they requested — was

issued, and two of the accountants testified at trial on behalf of the government.[1]

When the 1977 audit report was published, it disclosed in the "related party" footnote all monies recieved by petitioner through the project. With respect to both the 1976 and 1977 financial statements, the goverment's witnesses testified that the statements were fully in accord with accepted auditing standards, and contained no materially false or misleading statements. Nonetheless, the mailing of both reports constituted counts in the indictment.

4. The Indictment and Trial

On May 3, 1979, an indictment charging petitioner, his wife and his father-in-law with thirteen felony counts was returned. The thrust of the indictment was that the three defendants had devised a scheme to defraud Laurel of their disinterested services by "misappropriat[ing] the funds of Laurel for the payment of their personal debts and otherwise convert[ing] to their own use funds of Laurel" (Indictment 3, 5). Prior to trial the court dismissed five of the nine mail fraud counts because of various defects in the indictment. A sixth was dismissed at the close of the government's case. The court also ultimately granted a mistrial as to petitioner's wife and father-in-law.

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[1]The court of appeals stated that the accountants' cooperation with the F.B.I. "did not affect the scope of the audits" (p.16a,*infra*). The auditors' tesitmony, however, was that because of the F.B.I.'s interest, and in contrast to any previous audits of any organization, they carried out a surreptitious "desk search" of petitioner's office in which various materials were seized and made available to the government (Tr. Sept. 19, 1979, 28-29, 34).

During the prosecution's opening statement, the jury was told that the alleged scheme included (a) taking salaries and legal fees to which petitioner was not fully entitled, (b) taking loans at a time the corporation needed the money and (c) taking money under the guise of the construction project (Tr. 7-8). During the ten-week trial, however, the government maneuvered its way through a series of theory shifts. The theories changed so frequently that, with the trial near its end, the district judge — describing the prosecution's theories as "amorphous" — instructed the prosecution to prepare a written statement of its theories of the offense (Tr. 1649, 3267). Petitioner, at the same time, was told to cross-examine the government's witnesses on any possible theory that the government might use (Tr. 3476-78).

The "Government's Theories" were finally filed four trial days before the prosecution rested. By that point the government had failed to adduce proof that any of the loans, salaries or legal fees were excessive or concealed. Thus the sole remaining basis for the prosecution was the profit petitioner had received under the construction contracts.

As to this surviving element of the government's case, petitioner's defense was straightforward. Under common law principles, a person in a fiduciary role to a corporation could not profit from that position. If he did, and if he actively concealed such gain, the breach was fraudulent. In 1976, however, the Maryland legislature altered the common law as to related-party transactions by adopting a version of the Model Corporations Code which provides that corporate-fiduciary transactions are neither void nor voidable because of conflicting interests so long as they are fair and reasonable (i.e., the equivalent of an "arms length" transaction)(p. 29, *infra).* In this instance, peti-

tioner argued, the prosecution had failed to present any evidence as to the commercial unreasonableness of the contracts, much less, that Laurel had any choice but to turn to petitioner to comply with the Commission's ultimatum. The mere fact that petitioner had made a profit (concealed or not), as a related party did not invalidate the contracts; and that with the valid contracts, petitioner was lawfully entitled to the money he had received and thus could not be guilty of fraud.

At the close of the prosecution's case petitioner moved for judgment of acquittal. Although the district court agreed with petitioner that the government had failed to produce "a smidgen" of evidence as to the unreasonableness of the contracts, and further ruled that the Maryland statute was fully applicable to these contracts (Tr. 4744, and pp. 27a-29a, *infra*), the court ultimately ruled that "good faith" was an additional requirement that had to be shown to validate the contracts and that the prosecution had produced evidence from which the jury could find an absence of "good faith" by petitioner.

With the government's case closed, petitioner reasoned that the court had erred by adding a "good faith" standard to the "fair and reasonable" criteria explicit in the statute. Additionally, petitioner noted that the government had conceded that the Laurel board (including petitioner's sister who had no direct or indirect financial interest in the contracts) had approved the contracts with knowledge of petitioner's conflict:[2] an independent basis for validating the contracts under the state statute. *See* Md. Code Ann., Corp. & Ass'n Section 2-419(b)(1)(i), p. 3, *supra*. Under these circumstances the defense rested without presenting any testimony, and immediately

[2]*See* p. 26a, *infra*.

renewed the motion for acquittal. The court reserved decision on the motion and submitted the case to the jury. On the fifth day of deliberation the jury informed the court that it was deadlocked. After the court delivered an *Allen*-type charge, however, the jury finally returned a verdict of guilty on the seven counts still in the indictment. Then, after two months of post-trial briefing and a month's consideration of the motion, the court finally sustained the verdict on March 17, 1980.

5. The Appeal

Petitioner raised various errors on appeal with respect to the district court's interpretation of the Maryland statute.[3] In particular, petitioner pointed out that the court had erroneously added a requirement of "good faith" to a statute that on its face imposed only an arms-length fairness standard, that the court's instructions as to the state statute permitted the jury to convict petitioner even if they found that he entered into the contracts in good faith, and that the prosecution had failed to prove that the contracts were not properly ratified by the board pursuant to the statute.[4] In affirming the conviction the

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[3]Petitioner also contended on appeal (1) that the government's constantly-changing legal theories deprived him of due process of law; (2) that the district court had erroneously permitted the jury to consider irrelevant evidence; (3) that the admission of the auditors' testimony violated petitioner's privilege against self-incrimination (as to this contention, *see* pp. 19-22, *infra*); and (4) that certain of the mailings alleged were not sufficiently closely related to the scheme to support a mail fraud conviction.

[4]The court of appeals dealt solely with the issue of good faith, concluding that the addition of a good faith standard was correct. *See* p. 12a, *infra*. The court of appeals did not deal with petitioner's other challenges to the district court's interpretation and application of the Maryland statute, circumventing those questions by holding the statute inapplicable.

court of appeals ignored two of these errors by concluding—in contrast to the trial judge—that the state statute was "simply irrelevant." Even though the appellate court recognized that petitioner's defense "was founded upon the provisions of the Maryland Code" (p. 10a, *infra),* and that the trial court's "instructions insofar as they were based upon [the statute] were erroneous" (p. 13a, *infra),* the court concluded that petitioner was not entitled to a new trial because the instructions "introduced the general concept of the mail and wire fraud statutes" and were "substantially more favorable to the defense than the instruction would have been if it had been cast in the more traditional terms employed in mail fraud cases without reference to [the state statute]" (p. 13a, *infra*).

REASONS FOR GRANTING THE WRIT

I.

THE COURT OF APPEALS' AFFIRMANCE OF PETITIONER'S CONVICTION ON A LEGAL BASIS DIFFERENT THAN THAT ON WHICH HE WAS TRIED CONSTITUTES A DENIAL OF DUE PROCESS AND CONFLICTS WITH THIS COURT'S PRIOR DECISIONS

This case squarely presents an important question as to an appellate court's ability – consistent with the requirements of the Due Process Clause – to affirm a conviction on a legal basis entirely different than that upon which the case was tried and defended. In *Cole* v. *Arkansas,* 333 U.S. 196 (1948), and more recently in *Dunn* v. *United States,* 442 U.S. 100 (1979), this Court reversed appellate court decisions in which the basis for the affirmance of the conviction was different than that on which the conviction was obtained.

In this instance, the trial judge ruled, as a matter of law, that the state statute governing related-party transactions

was fully applicable to the contracts between petitioner and the corporation, and that if the contracts were valid, petitioner was lawfully entitled to the money he received and could not be guilty of fraud (pp. 27a-29a, *infra*). The district judge also found that the prosecution had failed to offer any evidence either as to the unreasonableness of the contract (Tr. April 4, 1980, at 25), or as to the absence of proper board ratification under the statute (p. 26a, *infra*).

Rather than evaluating the trial judge's rulings of law under the legal theory on which the case was tried, the court of appeals altered the legal theory and sustained petitioner's conviction on an entirely different interpretation of the law, an interpretation which was not presented to the jury. It did so without granting petitioner a new trial, as the court of appeals viewed the erroneous instruction as "substantially more favorable to the defense than the instruction would have been if it had been cast in the more traditional terms employed in mail fraud cases without reference to § 2-419" (p. 13a, *infra*). In other words, the court of appeals considered the district court's flawed interpretation of the law as harmless error.

The problem with the court of appeals' conclusion in this regard is that, in order to reach it, the court had to *assume* that petitioner's entire defense to the charges would have been the same even if the trial court had interpreted the law as did the court of appeals. The appellate court also had to *assume* that the jury — which deliberated five days even though petitioner presented no testimony whatever because of the availability of the statutory defense — would have reached the same verdict if petitioner had testified in his own behalf, presented character witnesses, and introduced other supportive testimony refuting that of various government witnesses.

Affirmance of a conviction under such circumstances constitutes an abridgement of petitioner's right of due process. In *Dunn,* this Court held that "appellate courts are not free to revise the basis on which a defendant is convicted simply because the same result would likely obtain on retrial." *Dunn* v. *United States,* 442 U.S. 100, 107 (1979). "To conform to due process of law, [defendants are] entitled to have the validity of their convictions appraised on consideration of the case *as it was tried* and *as the issues were determined* in the trial court." *Cole* v. *Arkansas,* 333 U.S. 196, 202 (1948) (emphasis added). An appellate court is thus limited to consideration of the legal theory on which the jury was instructed and based its verdict, and any discrepancy between the trial theory and that on which the court of appeals affirms "offends the most basic notions of due process." *Dunn* v. *United States, supra,* 442 U.S. at 106; *accord, Chiarella* v. *United States,* 445 U.S. 222, 236 (1980); *United States* v. *Carman,* 577 F.2d 556, 565 (9th Cir. 1978); *see also United States* v. *Hannah,* 584 F.2d 27, 30 (3d Cir. 1978).

This case illustrates the fundamental prejudice inherent in a *Dunn* violation. Because the trial court had ruled that Section 2-419 of the Maryland code applied, and found at the close of the prosecution's case that it had not introduced any evidence to prove the unreasonableness of the contract, petitioner did not take the stand or present any other affirmative defense. Petitioner already had voluntarily testified on several occasions before the grand jury and certainly would have done so again at trial to explain the absence of any *intent* to defraud if he had not received a judicial ruling that the Maryland statute was applicable in this case. For reasons pertinent to the situation that existed in light of the trial court's rulings, petitioner rested, preserving for appeal, if necessary, the various issues concern-

ing, *inter alia,* the Maryland statute which were, at that stage, presented in pristine form.[5]

Courts have recognized in other much less compelling contexts that lower court errors that have an integral effect on trial preparation and strategy are highly prejudicial to the defendant. *United States* v. *Castillo-Felix,* 539 F.2d 9 (9th Cir. 1976); *United States* v. *Lewis,* 511 F.2d 798, 801 (D.C. Cir. 1975); *United States* v. *Padrone,* 406 F.2d 560, 561 (2d Cir. 1969). There is simply no way to calculate the effect petitioner's testimony — or any other evidence he could have submitted — might have had on the jury. *See Levin* v. *Clark,* 408 F.2d 1209, 1212 (D.C. Cir. 1967). Even without that evidence the jury's lengthy deliberations and their deadlocked position reflect a delicate balance which might well have tipped in petitioner's favor on the issue of intent or another critical element.

The variance between the court of appeals' theory and that on which the conviction was obtained was called to the attention of the court in a timely petition for rehearing which was denied without opinion. This Court's decisions in *Dunn* and *Cole* were cited to the court of appeals and were apparently disregarded. The court of

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[5]In addition to his own testimony, petitioner could have presented various character witnesses — which testimony has been held in other cases to be of such significance that such testimony alone can create a reasonable doubt. *See, e.g., Michelson* v. *United States,* 335 U.S. 469, 476 (1948); *United States* v. *Hewitt,* 634 F.2d 277, 278-79 (5th Cir. 1981); *Kivitz* v. *SEC,* 475 F.2d 956, 961 & n.4 (D.C. Cir. 1973); *Klopp* v. *SEC,* 427 F.2d 455, 460 (6th Cir. 1970); *Johnson* v. *United States,* 269 F.2d 72, 74 (10th Cir. 1959). And he would also have had the opportunity to rebut, affirmatively, the testimony of various government witnesses by calling, among others, witnesses whom the government had presented to the grand jury or had interviewed but chose not to present at trial.

appeals' ruling therefore conflicts with governing precedent of this Court, and it must be reversed.

II.

THE COURT OF APPEALS ERRED IN HOLDING THAT A STATE STATUTE THAT SETS THE ACCEPTABLE STANDARD FOR RELATED-PARTY TRANSACTIONS IS IRRELEVANT TO A FEDERAL FRAUD PROSECUTION

This Court has found it necessary, in recent years, to curb the efforts of federal prosecutors to expand federal criminal statutes beyond their intended reach. Various reported decisions have repudiated attempts to apply penal sanctions to conduct which, even if not expressly covered by law, is thought by prosecutors to be morally repugnant or unfair. In *Chiarella* v. *United States,* 445 U.S. 222 (1980), for example, this Court reversed the criminal conviction of a printer who had made substantial profits utilizing insider information. This Court held that Section 10(b) of the Securities Exchange Act of 1934 did not cover such conduct, no matter how morally reprehensible the defendant's conduct may have been. The federal mail and wire fraud statutes provide a similar vehicle for prosecutors to reach conduct of questionable illegality. Both are particularly susceptible of misuse because the standard jury instruction for finding the defendant guilty encompasses any conduct which the jury decides is contrary to "public policy" or general notions of "uprightness and fair dealing." *See, e.g., United States* v. *Mandel,* 415 F.Supp. 997 (1976), *aff'd,* 602 F.2d 653 (4th Cir. 1979) (*en banc*), *cert. denied,* 445 U.S. 961 (1980). This case provides the Court the opportunity to add substance to these statutes at least in a context where standards of acceptable conduct have been established through the voice of a legislature.

Petitioner has been convicted of mail and wire fraud because he participated in contractual agreements which were lawful under Maryland law because they were fair and reasonable contracts fully performed by both sides. There is no allegation whatever that the work to be performed under the various contracts with the Laurel corporation was not performed or was not first rate, or that any money for the construction was paid above the amount specified in the contracts or that the contracts had not been properly ratified by the corporation's board of directors. Nor was there any evidence that the amount charged in the contracts was unfair or unreasonable, or exceeded what the company would have been charged by another contractor for the identical work.

Since petitioner's dealings with the corporation met the permissible criteria for "interested director transactions" established by Section 2-419 of Maryland's Corporations and Associations Law (pp. 2-3, *supra*),[6] petitioner could not be charged with mail or wire fraud under 18 U.S.C. §§ 1341 or 1343. This position is consistent with the language of the federal statutes, which authorize prosecution only of a "scheme or artifice to defraud." A course of conduct permitted by state law plainly cannot constitute a "scheme to defraud."

The significance of the court of appeals' ruling extends well beyond this particular case. The court of appeals, contrary to the district court, specifically held that the

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[6]The district court construed the statute as fully applicable to "interested officer" transactions (p. 39a, *infra*).

state-adopted standard for related-party transactions was "simply irrelevant" because "Maryland could not have immunized conduct violative of the federal mail and wire fraud statutes from prosecution in a federal court" (p. 13a, *infra*). As the court of appeals viewed it, federal fraud statutes are not limited to schemes *prohibited* by state law (p. 12a, *infra*). But the question is not whether federal fraud statutes reach only conduct prohibited by state law, but whether the federal statutes operate wholly independently of what a state legislature determines by statute to be "public policy" and "accepted standards of moral uprightness."

What the State of Maryland did in Section 2-419 of its Corporations Code was to declare self-dealing by corporate directors to be *within* acceptable standards. *See Epstein* v. *United States,* 174 F.2d 754, 768 (6th Cir. 1949). Section 2-419 does not "immunize" fraudulent conduct, but relegates corporation-related party self-dealing — *including* undisclosed or concealed self-dealing — to the category of constructive fraud which cannot support a mail fraud conviction. *See, e.g., United States* v. *Bohonus,* 628 F.2d 1167, 1172 (9th Cir.), *cert. denied,* 447 U.S. 928 (1980). The Maryland legislature, in enacting Section 2-419, has substituted for the imprecise standard of fraud under the federal fraud statutes a very precise and objective test of acceptable behavior for fiduciaries and other interested parties who deal with Maryland corporations. By holding Section 2-419 irrelevant, the court of appeals stripped that standard of its efficacy, and allowed petitioner to be convicted of conduct that has been intentionally condoned by the Maryland legislature as commercially acceptable. Conviction under the federal fraud statutes on the basis of conduct that a reasonable person is assured by law is acceptable in his or her state runs afoul

of the Fifth Amendment's proscription against a criminal law "that fails to give a person of ordinary intelligence fair notice that his contemplated conduct is forbidden . . . ." *United States* v. *Harriss*, 347 U.S. 612, 617 (1954); *see also Grayned* v. *City of Rockford*, 408 U.S. 104, 108-09 (1972); *Bouie* v. *City of Columbia*, 378 U.S. 347, 351-52 (1964).

III.

PETITIONER'S PRIVILEGE AGAINST SELF-INCRIMINATION WAS ABRIDGED BY THE USE OF STATEMENTS OBTAINED FROM HIM UNDER COMPULSION BY STATE AND FEDERAL AGENTS

A major aspect of the government's evidence as to the temporary concealment of petitioner's role in the construction project was provided by members of an accounting firm which served in a dual capacity as Laurel's private accountants and as state-approved auditors for the racing industry. Under the Maryland statutory scheme, all corporations licensed to engage in racing in the state must submit to an annual audit. *See* Md. Code Ann. art. 78B, § 10. Failure to do so subjects the licensee to forfeiture of the right to do business. Because accepted accounting standards require auditors to investigate all related party transactions as part of an audit, the accountants in this case insisted that the petitioner disclose his personal files pertaining to Howard Construction and two other entities, and make certain representations concerning his role in them.

Petitioner sought to exclude from trial the evidence which the accountants obtained from him. He contended that because the accountants had been instructed by the Maryland Attorney General and the Racing Commission to cooperate with the F.B.I.'s investigation, the auditors were operating as governmental agents in questioning him

about his financial affairs, that the information was given under the compulsion of the licensing requirement, and that no waiver could be implied since the auditors' true purposes were concealed from him.

The court of appeals conceded that petitioner "did have a privilege against governmental compulsion to produce [the information of his personal affairs obtained by the accountants]" (p. 15a, *infra*). And the court also concluded that "an inquiry and search of information to support or justify earlier statements by [petitioner] was necessary to completion of a full and complete statement of Laurel's financial affairs" (p. 16a, *infra*), which was the prerequisite to doing further business in the State. The court of appeals nevertheless found petitioner's Fifth Amendment claim unpersuasive for two reasons, neither of which is consistent with this Court's prior rulings in this area.

First, the court found that "the Maryland Racing Commission's requirement of an annual audit by independent accountants as a condition for licensing [did not] constitute impermissible governmental compulsion" (p. 16a, *infra*). In a total non-sequitur, the court of appeals likened the present situation to that in *Gardner* v. *Broderick,* 392 U.S. 273 (1968), concluding that because "no one sought a waiver of immunity" from petitioner, there was no compulsion (*id.*). As the court of appeals viewed it, "[i]n highly regulated industries, regulatory agencies may, indeed must, insist upon complete financial reporting to them as a condition of continued licensing" (pp. 16a-17a, *infra*).

The court of appeals, however, failed to address this Court's decision in *Spevack* v. *Klein,* 385 U.S. 511 (1967), where the Court found that the loss of employment or exclusion from a profession constituted the kind of compulsion necessary for purposes of the Fifth Amendment. In-

sistence upon a waiver of the privilege against self-incrimination, although an element of compulsion in itself, is not the operative fact in deciding whether testimony was compelled. It is the Hobson's choice between testifying or losing the right to do business which gives rise to the compulsion. In *Spevack* and in *Garrity* v. *New Jersey*, 385 U.S. 493 (1967), this Court held that a State may not use testimony in a subsequent prosecution that is originally elicited from a person under compulsion consisting of the State's right to fire that person from his employment. The court of appeals' ruling that "regulatory agencies may, indeed must, insist upon complete financial reporting to them as a condition of continued licensing," and can do so without infringing a person's Fifth Amendment privilege is clearly contrary to this Court's decisions in *Spevack* and *Garrity*.

The second basis for the court of appeals' denial of petitioner's Fifth Amendment privilege claim was that petitioner "did not claim it" (p. 17a, *infra*). Petitioner, of course, was not in a position to claim the privilege (or, more correctly, to waive it knowingly) since he was never informed that the state attorney general had instructed the accountants to cooperate with the F.B.I. in its investigation. *See Gardner* v. *Broderick, supra,* at 276 ("the privilege may be waived in appropriate circumstances if the waiver is knowingly and voluntary made"). Evidently recognizing the weakness of an "implied waiver" in this setting, the court of appeals skirted the problem by stating that "there is *an indication* that [petitioner] knew of [the F.B.I.] interest early in March, but he surely knew of the interest by the Racing Commission and that the financial statement required by the Racing Commission would be filed with it and other officials of Maryland as public documents" (p. 17a, *infra*) (emphasis added). But "the in-

dication" the court of appeals relied upon was not evidence as to petitioner's knowledge; rather, it was a statement in March 1978 by petitioner's wife (*after* the accountants had obtained numerous oral statements from petitioner which were introduced in evidence) reflecting knowledge of a contact between the accountants and the F.B.I., but nothing as to cooperation or assistance among them (p. 10a, *infra*). Moreover, the fact that petitioner "surely knew of the interest by the Racing Commission" and the required public filing of the financial statements of Laurel adds nothing to support an implied waiver. The government's evidence established that the 1977 financial statements contained neither false nor misleading information (Tr. 2075-78, 2082-86, 2036-38). Yet it was principally information garnered from petitioner by the State-F.B.I.-private auditors that was not contained in the public filings which the government adduced at trial against the petitioner.

Despite the court of appeals' effort to find "indications" sufficient to imply a knowing waiver of petitioner's Fifth Amendment privilege, this case squarely presents the question of whether the government was entitled to use information it gained in a setting in which petitioner was under a state-required mandate to cooperate, and did so without having been told that his interrogators (a private accounting firm) had been instructed by the State to assist the federal government in acquiring evidence for this prosecution. The evidence acquired in this fashion should have been excluded.

CONCLUSION

For the reasons set forth above, petitioner requests this Court to grant a writ of certiorari to review the decision of the court of appeals.

Respectfully submitted,

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October, 1981

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT
No. 80-5056

UNITED STATES OF AMERICA,
Appellee

versus

JOSEPH E. SHAMY,
Appellant

Appeal from the United States District Court for the District of Maryland, at Baltimore. James R. Miller, Jr., District Judge.

Argued February 6, 1981 Decided August 13, 1981

Before HAYNSWORTH, Senior Circuit Judge, PHILLIPS, Circuit Judge, and MICHAEL,* District Judge

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R Stan Mortenson (Miller, Cassidy, Larroca & Lewin on brief) for Appellant; Gale E. Rasin, Assistant U.S. Attorney and Robert B. Schulman, Special Assistant U.S. Attorney on brief) for Appellee.

*Honorable James H. Michael, Jr., United States District Judge for the Western District of Virginia, sitting by designation

HAYNSWORTH, Senior Circuit Judge

Joseph Shamy, a lawyer practicing in New Brunswick, New Jersey, became deeply involved in the affairs of Laurel Harness Racing Association which conducted harness horse racing meets in Maryland. Out of that involvement, he, his wife and father-in-law were jointly indicted on charges of mail fraud, wire fraud and racketeering. Early in the protracted trial, however, a mistrial was declared as to his wife and father-in-law. The trial proceeded as to Shamy, and he was convicted on all seven counts with which he was charged, three for mail fraud in violation of 18 U.S.C.A. § 1341, three for wire fraud in violation of 18 U.S.C.A. § 1343, and one for racketeering in violation of 18 U.S.C.A. § 1962. He was sentenced to concurrent four-year terms of imprisonment, and a fine of $31,000 was imposed. On his appeal we find no reversible error.

I.

Prior to 1974 Laurel was a public corporation with many stockholders. Its president, Richard Hutchinson, and members of his family, however, owned a majority of the outstanding shares. In that year Shamy and two of his clients, Joseph and Stephen Sobecko, began negotiating with Hutchinson for the purchase of a majority of the outstanding stock of Laurel.

The Maryland Racing Commission had been urging Hutchinson to effect substantial capital improvements at the racetrack. The prospective buyers were informed of this and, through Hutchinson, assured the Commission that they would construct a new club house and effect other extensive improvements at the track by the end of 1976. This led the Commission to make a contingent grant of additional racing days to Laurel.

In May, 1975 Shamy, the Sobecko brothers and Mike Brown purchased the Hutchinson stock and that of several other shareholders. The acquired stock represented 58% of Laurel's outstanding stock, and the purchase price was approximately $3,100,000. A loan from the Citizens Bank and Trust of Riverdale, Maryland to Shamy, his wife and the Sobecko brothers provided $2,200,000 of that amount, and the balance was due from the individual purchasers.

Shamy had some trouble raising his share of the purchase price. He raised some money by selling to Mike Brown the right to purchase one-half of his shares for a stipulated sum. He obtained $75,000 from Henry N. Stevens Company, a concessionnaire at Laurel, which Shamy treated as a personal loan to him but which Stevens treated as an advance to Laurel on their contract for the next racing meet. The remaining $110,000 Shamy obtained directly from Laurel's treasury. Shortly after Mike Brown began working at Laurel as secretary-treasurer, he discovered the $75,000 advance from Stevens and the $110,000 check to Shamy drawn on Laurel's account. When confronted with these matters by Brown, Shamy promised to repay the $185,000. Before doing so, however, in November, 1975 Shamy transferred his shares to the other three associates. His absence, if indeed he was absent, however, was shortlived.

Meanwhile, Shamy was encountering financial difficulties. He had a substantial ownership interest in Brunswick Burlington, Inc., which owned two low-rent apartment complexes in New Jersey. In the fall of 1975 that corporation was in default on its mortgage obligations to Commercial Trading Company of New York. Foreclosure was forestalled by an arrangement pursuant to which Catherine Lonski, Shamy's sister and Brunswick Burlington's bookkeeper, would disburse no funds from

rental receipts without the approval of one of Commercial Trading Company's vice presidents. Nevertheless, Brunswick Burlington's financial condition continued to worsen, and foreclosure was an imminent threat throughout 1976 and 1977.

In March 1976 Shamy was again very much on the scene at Laurel. He arranged for Daniel Rizk, Shamy's father-in-law and the superintendent of one of Brunswick Burlington's apartment complexes for which he got the free use of an apartment and a weekly wage, to purchase from the Sobecko brothers and Mike Brown their 58% interest in Laurel. The financial arrangement is not clearly revealed in the record. We do know that Rizk agreed to pay the $2.2 million dollar loan to Citizens Bank and Trust and the officers' loans payable to Laurel, including Shamy's original $185,000.

A new board of directors was elected, consisting of Rizk, his daughter Greta, who was Shamy's wife, and Catherine Lonski, Shamy's sister. Some 73,000 shares were registered in Rizk's name, while qualifying shares were registered in the names of Mrs. Shamy and Mrs. Lonski. Shamy was neither director, officer or shareholder, but was to serve as Laurel's general counsel. The new board elected Rizk its chairman and Mrs. Shamy Laurel's president.

Difficulties immediately faced the new management. The annual stockholders meeting was held in April 1976 and the minority stockholders were upset about the disclosure in the September 30, 1975 audit report of the large amounts the Shamy group had withdrawn from Laurel in the form of loans, salaries, legal fees and administrative expenses. In March the Maryland Racing Commission gave notice that Laurel's racing days would

be taken away if the promised improvements were not begun in two months and completed within a year.

Shamy undertook to act as the general contractor for the construction project, though he tried to conceal his identity in that capacity. He opened a bank account in the name of Howard Construction Company. Construction contracts were prepared and executed on behalf of Laurel by Shamy's father-in-law, wife and sister, and on behalf of Howard by Shamy's forging the name of Joseph Sage. Joseph Sage had experience in the construction business and acted as coordinator for work of the subcontractors on the Laurel construction project. Much later Shamy claimed that Sage had authorized him to sign the contract in Sage's name, but Sage denied having done so.[1]

The contracts provided for a fixed price of over $3,600,000 to be paid to Howard.

Construction began in the summer of 1976, but before Howard had incurred any expenses Shamy had Laurel issue a check to Howard for $25,000 on July 22 and another for $300,000 on July 29. Of the $325,000 thus acquired by Shamy from Laurel, he used $175,000 to reduce the officers' loans payable, an obligation which Rizk purportedly had assumed. This left a balance payable on those loans of $110,000 which was repaid in September 1976 after payments by Laurel to Rizk and Greta Shamy of $50,000 and $40,000, respectively, as salary, and to Shamy of $20,000 as a legal fee.

The Maryland Racing Commission required Maryland race tracks to publish financial statements prepared by

[1]On cross-examination at trial, Sage admitted telling his lawyer that he was not sure he had never given such authorization, but that his lawyer told him that it was too late to change his testimony already provided the grand jury.

Ernst & Ernst after an audit. Ernst & Ernst also did other accounting work for Laurel. In December 1976, Ernst & Ernst began its work on its audit for the twelve-month period ending September 30, 1976. When the auditors found the two July checks totaling $325,000 to Howard they requested production of the construction contracts. By a letter in January 1977, Shamy sent copies of the contracts to Ernst & Ernst and said that the $325,000 had been paid for site work done by Howard. In fact, the site work had not begun until several months after the two checks had been issued, and then it was performed by a subcontractor.

The auditors received word from another accounting firm that Shamy might have an interest in Howard. Three times they asked him about it. In response to the first inquiry Shamy wrote that he acted as general counsel for Howard. In response to the second inquiry, Rizk and Shamy signed a statement for inclusion in the audit report that Shamy served as general counsel for both Laurel and Howard Construction Company, but functioned in no other capacity for either and was not a stockholder in either. During a post-audit conference, Shamy told the auditors that Howard Construction Company was really Joe Sage. On two other occasions the Maryland Racing Commission was told that Joe Sage was the general contractor, once by Shamy and the other time by Mrs. Shamy. Shamy also told the stockholders that.

At the request of the auditors, Shamy produced a list of subcontractors. BBI Contractors and Advance Equipment Company were on the list. Neither of them had been on previous lists of contractors actually on the job which had been produced by other Laurel employees. According to the schedule Shamy produced, however, $229,000 had been

paid to those two concerns and another $250,000 was owed to them. Actually, the $150,000 recorded on Laurel's books as having been paid to BBI had been sent directly to Commercial Trading Company for application to Brunswick Burlington's mortgage. The checks made payable to Advance Equipment Company had been laundered through an account of Advance Car Wash and cleared with checks payable to Shamy.

When the auditors sought independent confirmations from the subcontractors, Shamy delivered to them what purported to be unsigned confirmation letters from BBI and Advance Equipment. He claimed they had been delivered to Laurel and he was simply passing them on to the auditors. The auditors, however, insisted that they wanted independent confirmation sent directly to them. Shamy then informed them that they should contact Mike Cannella of BBI and Roger Boutros of Advance Equipment. Mike Cannella actually was an employee of Brunswick Burlington whose telephone number Shamy had given the auditors. Cannella was instructed to answer the telephone saying "BBI." Efforts to contact Roger Boutros were unsuccessful.

Though he had previously denied any connection with BBI or Advance Equipment, two days before a scheduled meeting with Maryland's Attorney General Shamy finally admitted that he did have a connection with them. He still insisted, however, that the two concerns were legitimate and had performed work at Laurel.

On March 8, 1978 the scheduled meeting with the Attorney General of Maryland and representatives of Ernst & Ernst was held. Mrs. Shamy and a lawyer attended. The Attorney General, informed of misrepresentations by Shamy to Ernst & Ernst, asked Mrs. Shamy to produce the

books and records of BBI and Advance Equipment. She agreed to do that. On March 13, however, Mr. and Mrs. Shamy refused to produce them for inspection by Ernst & Ernst. Since Ernst & Ernst could not obtain those records, its December 31, 1977 report covering the preceding fifteen months, included a scope limitation note.

Early in 1979 Shamy, in an appearance before a federal grand jury in Maryland, produced files purporting to be those of Advance Equipment and BBI. The files contained bills which, like the subcontracts and confirmation letters, represented that BBI and Advance Equipment had performed specified work at Laurel which actually had been performed by legitimate subcontractors. Earlier, in May 1978, testifying as a witness in a civil suit in Maryland, Shamy swore that Advance Equipment and BBI were legitimate subcontractors who had done so much work at Laurel that they would make no profit on it.

In the schedules delivered by Shamy to Ernst & Ernst in February 1978, Shamy claimed aggregate overhead expenses for Howard in the amount of $497,917 and a profit of $403,432. Of course, the monies paid to and reportedly due BBI and Advance Equipment were included in the hard construction cost figures. Shamy refused to prepare a breakdown of his claimed overhead costs, claiming that it would put him to an unreasonable and highly burdensome amount of trouble. Later, in the Maryland civil suit, he testified that he had produced records for Ernst & Ernst which detailed and substantiated the claimed overhead expenses.

The trial was firm in unrebutted proof that Howard's overhead expenses could not have exceeded $57,000. During the construction process there had been two people at Laurel who were paid, at least in part, by Howard, but

employees of Laurel handled all the administrative and clerical work. Howard had no office staff and incurred no housing or utilities expenses.

Reconciled, Shamy's profits in the name of Howard on the Laurel project substantially exceeded $1,200.00.

On August 1, 1977, Shamy drew $170,000 from Laurel, using $160,000 of it to pay interest on the Citizens Bank and Trust Loan.

In July and August 1977 the Shamys purchased an interest in the Mayflower Hotel in Atlantic City, New Jersey, using $250,000 drawn by Shamy on his construction contracts with Laurel. In December 1977 they sold a portion or most of that interest for $254,000. That money went to Mrs. Shamy's personal checking account from which she then "lent" $100,000 to Laurel and gave her father a check for another $100,000.

In November 1977 the FBI apparently was investigating the flow of money into Atlantic City. FBI agents sought from Ernst & Ernst information about Laurel which would be developed during the course of an audit for the fifteen month period ending December 31, 1977. The Maryland Racing Commission authorized Ernst & Ernst to cooperate with the FBI and, in a meeting in December, Ernst & Ernst agreed to obtain certain information for the FBI. There was no other meeting with the FBI until March 1978 when Ernst & Ernst took the position that it could not produce any of their working papers without a subpoena. Later the work papers were turned over to the government pursuant to a federal grand jury subpoena.

Ernst & Ernst did not immediately tell Shamy of the FBI's interest. Shamy contends that he did not know of it when he was supplying Ernst & Ernst with information

about Howard, BBI and Advance Equipment in 1978. In a summary of the meeting of March 8, 1978 with the Attorney General of Maryland, Mrs. Shamy and her lawyer, prepared by one of Ernst & Ernst's accountants, there is a strong indication that she knew of it then. The lawyer was highly critical of Ernst & Ernst for having long delayed resolving what he described as the very minor problems of BBI and Advance Equipment. Mrs. Shamy is then said to have expressed a belief that Ernst & Ernst had overracted to a visit from the "big, bad FBI and got scared to complete the audit."

It was not until the stockholders meeting in May 1978 when the December 31, 1977 financial report was released that the minority stockholders of Laurel and the Racing Commission learned that Shamy was the owner of Howard, BBI and Advance Equipment.

Finally, in September 1978 Shamy negotiated a loan of $4.5 million from the National Bank of Washington, pledging Laurel's physical assets as security. With the proceeds of that loan, he paid off the $2.2 million borrowed by the acquiring stockholders from Citizens Bank and Trust and $1.2 million which had been borrowed by Laurel for use in the payment of construction costs. The remainder was used in the acquisition of stock from minority stockholders.

II.

Shamy's defense was founded upon the provisions of the Maryland Code, *see* Md. Corp. & Ass'ns Code Ann. § 2-419 (1980 Cum. Supp.), which provides that a contract between a corporation and an interested party is not void or voidable solely for that reason if it is ratified by a majority of disinterested directors or if it is fair and

reasonable.[2] For a time, Shamy's adroit lawyers seemingly persuaded the district judge that § 2-419 clothed the construction contracts between Laurel and Howard with complete legitimacy unless the United States could prove beyond a reasonable doubt that the contracts were unreasonable and unfair to Laurel. The statute expressly places the burden of proving fairness and reasonableness upon the party asserting the validity of the contract. But in the context of a criminal case, Shamy contended that the burden to prove unfairness and unreasonableness was upon the prosecution. We would have supposed the inherent unfairness and unreasonableness would have been self-evident, but the trial judge worried, at least for a time, about the absence of affirmative proof that an independent construction company would have done the work for substantially less. In the end, however, the district judge concluded that a requirement of good faith was implicit in § 2-419.[3] Thus, he instructed the jury that it could not find the existence of a scheme to defraud unless it found that, at the time the construction contracts were executed, they were unreasonable and unfair to Laurel or that there was bad faith on Shamy's part at that time.

The inclusion of the bad faith component in the instruction is the basis of Shamy's principal contention on appeal. He finds no good faith requirement in § 2-419 and contends that without a finding that the construction contracts at the outset were unreasonable and unfair to Laurel, all of the evidence of Shamy's concealments and falsehoods, as well as the amount of his gain, was entirely

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[2]By its terms, the statute applies only to interested director transactions, but the district court found that the Maryland courts had applied it to contracts with other corporate employees and fiduciaries.

[3]Such a requirement is explicit in § 2-405.1(a). *See* Md. Corp. & Ass'ns Code, § 2-405.1 (1980 Cum. Supp.).

irrelevant. Since the contracts were lawful under Maryland law, he contends that he had the legal right to do what he wished with the money flowing to him by reason of his lawful contracts.

Shamy simply misreads the statute.

Prior to 1976, the Maryland Code contained no such provision. There was a per se rule that any contract between a corporation and one of its directors or an entity in which the director had a substantial interest was void or voidable. Section 2-419 was enacted in that year to conform Maryland's law to that of most other states. The statute expresssly provides that a contract is not void or voidable *solely* because of a common directorship or interest if the transaction is reasonable and fair to the corporation. There is no room for implication of the notion that the transaction may not be void or voidable for some other reason. Thus, Shamy was not disqualified from entering into a fair and reasonable construction contract with Laurel if there had been frank and open disclosure of his interest and of all relevant data, including the amount, if any, of his anticipated profits. Through such open disclosure, all of the relevant facts and circumstances would have been communicated, not just to his wife, sister and father-in-law, but to minority stockholders as well. Section 2-419 simply cannot be read as supplanting § 2-405.1(a).

III.

In our view, the Maryland statutes were simply irrelevant in this case. We have held that a "scheme or artifice to defraud" within the meaning of the mail and wire fraud statutes is not limited to fraudulent schemes within the meaning of the common law or as prohibited by state law.

It reaches deceptive schemes which are "contrary to public policy and conflict with accepted standards of moral uprightness, fundamental honesty, fair play and right dealing." *United States v. Mandel,* 591 F.2d 1347, 1361 (4th Cir. 1979), *vacated on other grounds, United States v. Mandel,* 602 F.2d 653 (1979) *(en banc).* Any breach of a fiduciary duty by a corporate employee effected in part by the use of the mails may be a violation of the federal mail fraud statute, at least when accompanied by concealment or a failure to disclose relevant and material information. *See United States v. Barta,* 635 F.2d 999, 1006-07 (2d Cir. 1980).

Even had it wished to do so, Maryland could not have immunized conduct violative of the federal mail and wire fraud statutes from prosecution in a federal court.

Though the instructions, insofar as they were based upon § 2-419, were erroneous, they suggest no need of a new trial. The submission of the question of good faith introduced the general concept of the mail and wire fraud statutes and it was substantially more favorable to the defense than the instruction would have been if it had been cast in the more traditional terms employed in mail fraud cases without reference to § 2-419. The jury was required to find bad faith on Shamy's part at the time the contracts were executed. Since the jury was also clearly required to find a scheme to defraud in order to convict, the jury clearly found every element of the offenses under instructions more favorable to Shamy than his entitlement.

IV

Shamy's lawyer suggests that he was taken by surprise by the inclusion of the bad faith component in the jury instructions and that he was confused by the shifting

theories of the prosecution. When the prosecution rested, no defense was offered on Shamy's behalf. Defense counsel suggests that he might have made different tactical decisions if he had not been confused or misled.

Confusion was introduced into the trial, but it came from defense counsel's persistent insistence that the only triable issue was the reasonableness or unreasonableness and fairness sor unfairness of the construction contracts at their inception. If, as it appears, he tentatively persuaded the trial judge, he scarcely is in a position to complain that the trial judge finally realized that he had been pressing for a submission to the jury on an issue which, at least in part, was irrelevant.

In seeking to support the admission of particular items of evidence, the prosecution did advance some novel theories, but this was in the face of defense counsel's objection that nothing was relevant except evidence going directly to the fairness and reasonableness of the construction contracts. The prosecution's theory was clearly stated in the indictment, and, except for statements during skirmishes over the admission of particular items of evidence, the prosecution adhered to that theory. There was no surprise or confusion affecting the fairness of the trial. The most that can be said is that defense counsel suffered the disappointment of not entirely succeeding in transferring the battle to ground of his own choosing.

V.

Shamy complains of the introduction of evidence relating to several different matters, such as the payment of salaries and legal fees which were not shown by separate proof to have been unlawful, the purchase of an intrest in the Mayflower Hotel in Atlantic City, and the application

of funds derived from Laurel to interest payments on personal loans. But the prosecution was entitled to remove the curtain from the entire picture. Evidence of Shamy's need, and that of the controlling stockholders, for large sums of money, and the manner in which those funds were acquired were highly relevant to proof of the scheme to defraud charged in the indictment. Surprisingly, there is also a contention that proof of the payments to BBI and Advance Equipment was irrelevant since it is said there can be no such thing as "double billing" in the context of a fixed price contract. It is true that Shamy repeatedly stated that BBI and Advance Equipment had performed work which they had not performed and which had been performed by others, but the evidence came in not for the simple purpose of showing that more than one person had been paid for doing the same work but to show Shamy's persistent attempt to conceal his own profit. That concealment is highly relevant to the proof of the scheme.

VI.

Shamy next complains that the introduction of evidence obtained by Ernst & Ernst during the course of its audit was a violation of his Fifth Amendment privilege against self-incrimination .

Most of the information obtained by Ernst & Ernst during the course of the audit was derived from corporate records. Neither a corporation nor its officers have a privilege not to have corporate records disclosed, for the privilege is purely a personal one. *See Bellis v. United States,* 417 U.S. 85 (1974). Shamy, however, did produce information about Howard and about BBI and Advance Equipment. The information he produced was laced with falsehoods, but Shamy did have a privilege against governmental compulsion to produce it. He contends that the

auditors were acting as governmental agents in questioning him about his financial affairs and about the things he had done in the names of Howard, BBI and Advance Equipment.

The FBI's interest in the audit and the auditors' guarded cooperation with the FBI did not affect the scope of the audits. Justifiably, Ernst & Ernst became suspicious of Shamy. An inquiry in search of information to support or justify earlier statements by him was necessary to completion of a full and complete statement of Laurel's financial affairs. Nor did the Maryland Racing Commission's requirement of an annual audit by independent accountants as a condition for licensing constitute impermissible governmental compulsion. Shamy's reliance on *Gardner v. Broderick,* 392 U.S. 273 (1968), is misplaced.

In *Gardner* it was held that a public official or employee may not be discharged for refusing to sign a waiver of any immunity to which he is entitled when questioned about his official conduct. Evil was perceived in the absolute requirement of a formal waiver of immunity before the questioning began. The court made it explicitly clear, however, that such a person, who is not asked to waive his immunity before testifying or responding to questioning, may be discharged for refusing to answer, even though his refusal to answer is based upon a claim of his Fifth Amendment privilege against self-incrimination. *See* 392 U.S. at 278. Here, no one sought a waiver of immunity by Shamy. The Racing Commission's requirement that licensed race track operators submit to an annual audit is like a local government requiring public employees to respond to questions about their official conduct. *See Pinkney v. District of Columbia,* 439 F.Supp. 519, 532-34 (D.D.C. 1977). In highly regulated industries, regulatory

agencies may, indeed must, insist upon complete financial reporting to them as a condition of continued licensing.

Shamy's claim of privilege cannot prevail for another reason. He did not claim it. He insists that he could not be found to have waived his privilege when he did not know of the interest of the FBI in the audit. There is an indication that he knew of their interest early in March, but he surely knew of the interest by the Racing Commission and that financial statements required by the Racing Commission would be filed with it and other officials of Maryland as public documents.

Nor was Shamy entitled to *Miranda* warnings, *see Beckwith v. United States,* 425 U.S. 341 (1976), or to a warning that the FBI had contacted the auditors about its interest in Shamy's affairs. *See Hoffa v. United States,* 385 U.S. 293, 303-04 (1966); *United States ex rel. Milani v. Pate,* 425 F.2d 6 (7th Cir. 1970). Shamy's reluctant cooperation with the auditors was voluntary.

VII.

We find nothing in Shamy's contention that the relevant mailings in the mail fraud counts were not sufficiently closely related to his scheme to defraud to bring his conduct within the statute.

Since we found no other basis for reversal, the convictions on all counts of this faithless servant who covertly enriched himself at the expense of the corporation to which he owed his loyalty are affirmed.

AFFIRMED

—x—x—x— —x—x—x—x—

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT
No. 80-5056

UNITED STATES OF AMERICA,

Appellee,

versus

JOSEPH E. SHAMY,

Appellant.

ORDER

Upon consideration of the petition for rehearing, no poll of the court having been requested on the suggestion of rehearing *en banc*, and with the concurrence of Judge Phillips and District Judge Michael,

IT IS ORDERED that the petition for rehearing be, and it hereby is, denied.

/s/ Clement F. Haynsworth, Jr.
Senior United States Circuit Judge

FILED
SEP 25, 1981
FOURTH CIRCUIT

September 22, 1981

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

UNITED STATES OF AMERICA	)	
	)	
VS.	)	CRIMINAL No. M-79-0191
	)	
JOSEPH E. SHAMY	)	
	)	

MEMORANDUM AND ORDER

Motions for judgment of acquittal on various grounds have been filed by the defendant at the conclusion of the Government's case-in-chief. Remaining in the indictment are three counts of mail fraud (Counts 1, 3, and 10), three counts of wire fraud (Counts 6, 7, and 12), and one RICO count (Count 13). All counts are based upon an alleged scheme to defraud which is set out in Count 1.

The defendant has contended, among other things, that the crux of the Government's case involves the reconstruction project at Laurel and money which Joseph Shamy received or which was expended for his benefit through the vehicle of three contracts which Laurel had with Howard Construction Company, a sole proprietorship of Joseph Shamy. Contending that the Government has not shown the contracts were unfair to Laurel, defendant says that the contracts were valid under Maryland law and that, therefore, there can be no active fraud which is required for violation of the mail or wire fraud statutes, citing *Epstein v. United States,* 174 F.2d 754 (6th Cir. 1949).

In this context, the court must deny the motion for judgment of acquittal if evidence has been introduced

which, when viewed in the light most favorable to the Government, could form the basis for a finding beyond a reasonable doubt of every fact essential to convict.

Although the theories of the Government in this case have seemingly shifted from time to time, the court has concluded that, at least at this stage of the case, it must apply the evidence against any reasonably supported by the indictment, whether or not the Government has clearly or expressly enunciated the theory during the trial as the basis for its case.

The reach of the mail fraud and wire fraud statutes is not unlimited. *See e.g. Epstein v. United States,* 174 F.2d 754 (6th Cir. 1949); *United States v. Rabbitt,* 583 F.2d 1014 (8th Cir. 1978); *United States v. Dixon,* 536 F.2d 1388 (2d Cir. 1976); *United States v. McNeive,* 536 F.2d 1245 (8th Cir. 1976). Although there is broad language in many of the cases indicating that state law is relevant only to the issue of intent to defraud where there has been non-disclosure or concealment of material information, such language must be "considered in the proper context of the opinion in which [it] appear[s]. It is a general rule that expressions in an opinion are to be considered in the light of the factual context of the case." *United States v. McNeive, supra,* at 1250.

The difficulty in a particular case, especially one dealing with concealment, non-disclosure, or misrepresentation of information, is whether the alleged scheme satisfies the fraud element of the mail fraud and wire fraud statutes. *United States v. Mandel,* 591 F.2d 1347, 1362-63 (4th Cir. 1979). A failure to disclose material information, although it might constitute a breach of a fiduciary duty, can never be the basis of a conviction under the mail fraud or wire fraud statutes unless the breach of the fiduciary duty is

linked with some active fraud. *Id.* Although fraud is difficult to define, it has been stated that it needs no definition and that "it is as old as falsehood and as versable as human ingenuity," *Weiss v. United States,* 122 F.2d 675 at 681 (5th Cir. 1941). Courts have broadly construed the words "scheme or artifice to defraud" and have said that the mail fraud statute [and the wire fraud statute by analogy] ". . . generally [have] been available to prosecute a scheme involving deception that employs the mails in its execution that is contrary to public policy and conflicts with accepted standards of moral uprightness, fundamental honesty, fair play and right dealing." *United States v. Mandel, supra* at 1361. Courts have failed to limit the term "scheme or artifice to defraud" to common law definition of fraud and false pretenses or to schemes *prohibited* by State law, *id.*

To say the foregoing, however, does not mean that an act which is affirmatively approved under State law, as opposed to merely having been not punished by State law, can be encompassed within the term "scheme or artifice to defraud." In the ordinary case, where an act or series of acts have been expressly approved by the affirmative process of legislative enactment, or by state courts of last resort in the pertinent jurisdiction, such acts or series of acts could not be contrary to public policy or conflict with accepted standards of moral uprightness, fundamental honesty, fair play and right dealing for the purposes of the mail fraud statute. The court has found no case, nor has one been cited to it, which, on its facts, contradicts that seemingly eminently sound conclusion. It is also true that in order for there to be a scheme to defraud, there must be, even in a case in which affirmative misrepresentation has occurred, evidence from which it may be inferred that some actual injury to the victim, however slight, is a

reasonable probable result of deceitful representations if they are successful. In absence of such evidence, a potential victim might be deceived, but not be defrauded. The purose of the scheme must be not only to deceive, but also to injure or gain some *undue* advantage *United States v. Regent Office Supply Co.*, 421 F.2d 1174 (2nd Cir. 1970). *See also United States v. Sinclair*, 433 F. Supp. 1180 (D. Del. 1977).

The indictment alleges a two pronged scheme and artifice to defraud:

> "13(a) To obtain directly and indirectly from Laurel and the stockholders of Laurel money, property, and other things of value by means of false and fraudulent pretenses, representations, and promises, the defendants then well knowing that the pretenses, representations, and promises were false and fraudulent when made.
>
> "(b) to defraud Laurel and its stockholders of their right to the conscientious, loyal, faithful, honest, disinterested, and unbiased services, decisions, actions and performances of duties of defendants in their official capacity, including but not limited to their duties as officers and agents of Laurel, free from willful omission, dishonesty, misconduct, fraud and conflict of interest."

The indictment elaborates that it was further a part of the scheme to obtain substantial sums of money from Laurel for the personal and financial benefit of the defendants through participating in decisions of Laurel "with respect to activities in which they had a financial and proprietary interest . . . while concealing the interest and

payments by various misrepresentations . . . concerning the true nature and extent of defendant Joseph E. Shamy's financial and proprietary interest in and relationship to Howard Construction Company, the general contractor for the renovation and construction at Laurel, and his financial and proprietary interest and relationship to Advance Equipment Company and BBI Contractors." [¶ 16 of Indictment].

Paragraph 17 of the indictment reiterates that it was a part of the scheme that the defendants attempted to conceal monies paid directly or indirectly from Laurel to them through Howard Construction Company, BBI Contractors, and Advance Equipment Company. It is further stated in Paragraph 18 of the indictment that it was a part of the scheme to defraud that they caused Laurel to pay monies for work which they falsely represented had been performed by BBI Contractors and Advance Equipment Company. Paragraph 19 of the indictment reiterated that the defendants misappropriated the funds of Laurel.

Although the indictment could conceivably have been read to charge a scheme to defraud, not only Laurel and its stockholders, but also the Maryland Racing Commission and Ernst & Ernst (*see* paragraphs 16 and 17 of the indictment), the Government has made clear during the trial that the fraud alleged is against Laurel and its stockholders only through (1) a breach of Shamy's fiduciary duty by intentional concealment and (2) by a taking of Laurel's money by false pretenses. (Government's response to defendant's motion for judgment of acquittal based upon the Government's unproven and unconstitutional contention that defendant Shamy received unreasonable and excessive salaries, fees, loans, and profits, p. 2; Government's theories, p. 11).

The Government has stated, and the court agrees, ". . . that the focus of this case has been the construction project at Laurel and the manner in which the defendant [allegedly] used it for self-enrichment, all the while that he concealed and lied about the benefits he was receiving" (Government's Response to defendant's motion for judgment of acquittal based upon the Government's unproven and unconstitutional contention that defendant Shamy received unreasonable and excessive salaries, fees, loans, and profits, p. 2).

The Government has not contended that the directors of Laurel were unaware of the connection that Joseph Shamy had with Howard Construction Company nor with BBI and Advance. In fact, the Government has contended, to the contrary, that they knew the pertinent facts and, at least as to Greta R. Shamy and Daniel Rizk, were two of the schemers. There is no evidence that the relationship of Joseph Shamy to Howard Construction Company, to BBI Contractors nor to Advance Equipment Company was not disclosed to the three directors, Catherine Lonsky, Greta R. Shamy, and to Daniel Rizk. The management of a corporation is entrusted to the Board of Directors, and notice to the Board of Directors is notice to the corporation, *Md. Ann. Code* "Corporations and Associations, sec. 2-401. The Directors have the obligation to act in good faith, in a manner which the director reasonably believes to be in the best interest of the corporation and with the care that an ordinarily prudent person in a like position would use under similar circumstances, *Id.*, sec. 2-405.1. In case of the adoption of a contract by the corporation with a related party, the minority stockholders have no right to challenge successfully on behalf of the corporation an interested party transaction if, in approving the transaction, the directors have acted in good faith,

in a manner which they reasonably believe to be in the best interest of the corporation, with the care that an ordinarily prudent person in a like position would use under similar circumstances, and the contract or transaction is fair and reasonable to the corporation. *Id.*, sec. 2-405.1 and sec. 2-419. Where an employee makes full disclosure in good faith, and the employer nevertheless agrees to the employee being in a conflict of interest situation, no right exists in a minority stockholder to overturn the transaction or to void it, provided that the approving directors act in good faith and that the transaction is fair to the corporation. *Chesapeake Construction Corp. v. Rodman,* 256 Md. 531 (1970); *Shipley v. Meadowbrook Club,* 211 Md. 142 (1965); *Maryland Credit* v. *Hagerty,* 216 Md. 83 (1958).

In the present case, the minority stockholders did not have an absolute right to ratify the contract with Howard Construction Company. Assuming that the directors were acting with full knowledge and in good faith in approving the contract, the minority stockholders had only the right to have the contract declared void as one which was not fair and reasonable to the corporation. If the contract was not fair to the corporation and was not entered into in good faith by the defendant, the minority stockholders might have been displeased but they could not have prevented the bargain being made, assuming that the directors also acted in good faith in approving it. Simply put, the corporation, acting through its directors, had the responsibility for deciding whether or not to accept the contract with Howard Construction Company, and not the minority stockholders, provided, of course, that the transaction was entered into in good faith and that it was fair to the corporation. This being so, the necessary intent to defraud on the part of Shamy cannot be proven simply

by showing that he misrepresented to the minority stockholders his relationship to Howard Construction Company and that he intended to deceive the minority stockholders in that respect, but it must also be shown that he did so with the intention to gain an undue advantage for himself. *United States v. Regent Office Supply Co., supra.* Evidence of an intention to defraud could be that he misrepresented the facts to the minority stockholders and others, that the contract under the circumstances was not one which was fair and reasonable to the corporation and that his concern was primarily for his own pocket rather than for the good of Laurel.

In order to submit this case to the jury on the theory that the defendant Shamy breached his fiduciary duty to Laurel and the minority stockholders by concealing from them his true relationship to Howard Construction Company, the court must conclude that there is evidence sufficient to justify a finding beyond a reasonable doubt that:

(1) Shamy misrepresented his true relationship with Howard Construction Company to the minority stockholders and others for purpose of deceiving the minority stockholders;

(2) Such deception was a part of a scheme to defraud Laurel and the minority stockholders of their right to the loyal, faithful and true services of Joseph Shamy as an employee of Laurel for the personal of profit of Joseph Shamy or others at the expense of Laurel; and

(3) He did so with intention to defraud Laurel.

The court believes that there is sufficient evidence to allow the case to go forward on the above theory at this time.

The other theory which the court believes is one possible

to be submitted to the jury under the indictment and record in this case is that Shamy was a part of a scheme to defraud Laurel and its minority stockholders by means of siphoning funds from Laurel in connection with the construction through the Howard Construction Company contract with Laurel. The court concludes that in order to submit the case to the jury on that theory, there would be required to be evidence sufficient to justify finding beyond a reasonable doubt that:

(1) Shamy was part of a scheme to convert funds which belong to Laurel through the means of the Howard Construction Company contract.

(2) That the contract, at the time it was entered into, was not entered into by Shamy in good faith and/or it was not one which was fair to Laurel.

(3) Shamy entered into the scheme and performed acts with the intention to defraud Laurel and its minority stockholders.

In connection with this second theory, the burden will be on the Government to show that the contract was not entered into by Shamy in good faith and/or that it was not one which was fair to Laurel. Since it appears under the circumstances of ths case that one or both of those elements are essential to constitute the crime charged, the rationale expressed in *Mullaney v. Wilbur,* 421 U.S. 684 (1975), and *In Re Winship,* 397 U.S. 358, 364 (1970), places that burden upon the Government to prove the same beyond a reasonable doubt.

In connection with both the first and second theories, another way of stating the fairness test is whether an independent corporate fiduciary in an arm's length bargain would have bound his corporation to such a contract under all the circumstances then existing. *See Pepper v.*

Litton, 308 U.S. 295 (1939); *Fliegler v. Lawrence,* 361 A.2d 218 (Del. 1976); Henn, *Law of Corporations,* 2d ed. 1970, sec. 238 at pp. 466-67.

The court believes that there is sufficient evidence, construed in the light most favorable to the Government, to allow the case to proceed at this time on the first and second theories.

At this time, the court believes that there is not a fatal variance.

The motion for judgment of acquittal at the conclusion of the Government's case is DENIED.

It is so ORDERED this 5th day of December, 1979.

/s/ James R. Miller, Jr.
JAMES R. MILLER, JR.
United States District Judge

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

UNITED STATES OF AMERICA	)	
	)	
VS.	)	CRIMINAL No. M-79-0191
	)	
JOSEPH E. SHAMY	)	
	)	

ORDER

Upon consideration of the motions for judgment of acquittal (F.R.Crim.P. 29) or, in the alternative, for a new trial (f.R.Crim.P. 33), and for reasons which will be set out in a Memorandum Opinion to be filed hereafter, the motion is denied both as to a judgment of acquittal and as to a new trial.

It is SO ORDERED this 17th day of March, 1980.

/s/ James R. Miller, Jr.
JAMES R. MILLER, JR.
United States District Judge

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

UNITED STATES OF AMERICA	)	
	)	
VS.	)	CRIMINAL No. M-79-0191
	)	
JOSEPH E. SHAMY	)	
	)	

MEMORANDUM OPINION

Presently pending before the court is Joseph Shamy's motion for judgment of acquittal, (F.R.Crim.P. 29) or in the alternative, motion for a new trial (F.R.Crim.P. 33). In ruling upon a motion for judgment of acquittal n.o.v. the court is required to examine the evidence in the light most favorable to the government. The trial court should grant a judgment of acquittal n.o.v. if there was insufficient evidence to allow a reasonable man to find the defendant guilty beyond a reasonable doubt. In ruling upon a motion for new trial the court may consider the credibility of the witnesses, weigh the evidence, and, if it is deemed necessary, set aside the verdict to prevent a miscarriage of justice. *United States v. Wechsler,* 406 F.2d 1032, 1033 (4th Cir. 1969); *see,* 8A *Moore's Fed. Prac.* ¶ 29.09 [1] at 29-53.

In ruling on defendant's motion to dismiss, this court issued a memorandum and order dated December 5, 1979 (Paper No. 113). In said memorandum this court distinguished between active fraud (i.e. the defrauding of the corporation or its stockholders of money, goods or services) as opposed to passive fraud (i.e. misrepresenta-

tions which constitute a breach of a fiduciary duty but do not result in a loss to the corporation or its stockholders). This court concluded that at least an attempt to commit an active fraud is required to be proven to establish an offense under the mail and wire fraud statutes and that on the evidence presented by the government there were two theories upon which an active fraud could arguably have been made out to the jury.

The first theory is that Joseph Shamy defrauded the Laurel Harness Racing Association (LHRA) by failing to provide loyal and faithful services to the corporation in his capacity as corporate counsel and as administrator. This theory contemplates that the failure to provide such loyal and faithful service goes beyond a mere breach of a fiduciary duty and amounts to (1) the fraudulent deprivation of the corporation of the salary he was being paid in his capacity as a corporate officer and (2) the use of his fiduciary position for personal gain.

The second government theory is that Joseph Shamy defrauded LHRA by diverting from the corporation to himself funds from the construction project to which he was not entitled. An essential part of this theory is that the contracts, which were entered into between Howard Construction Company (HCC) and LHRA, were invalid. If the contracts were invalid, then the defendant was not entitled to substantial funds which he received directly and indirectly from the corporation as a result of the construction contracts. If the receipt of such funds by the defendant was accompanied by an intent to defraud the corporation, then the jury could reasonably have concluded that the defendant actively defrauded the corporation.

The defendant presented no testimonial evidence in his own case, and after hearing closing arguments and instruc-

tions, the jury returned with a guilty verdict on all counts submitted to it.

The court has re-examined both the faithful service theory and construction project theory and has concluded that the jury could have properly found beyond a reasonable doubt from the evidence presented that the defendant defrauded the corporation under either or both of the theories

DISCUSSION

I. Faithful Service

As an officer and employee of LHRA, Joseph Shamy had an obligation under Maryland Law to give LHRA his loyal, faithful and true services. *Maryland Metals v. Metzner,* 282 Md. 31, 37 (1978). He was obliged not to use his position of trust to benefit personally at the expense of the corporation. Such an obligation on Shamy's part was particularly strong in view of the fact of his position as corporation counsel, thereby placing him under the dual strictures of the fiduciary relationship as an employee and officer and of the Code of Professional Responsibility (Md. Code Ann., Vo. 9C, Appendix X) to which lawyers are held in the State of Maryland and elsewhere.

There is ample evidence from which the jury could have reasonably concluded that Joseph Shamy intentionally deprived the corporation of his loyal an faithful services. The factual misrepresentations, the forged signature on the contracts, and the failure to bring in outside counsel (as he stated at a stockholders meeting that he would do), to advise the corporation before it entered into the aggregate $3.6 million construction contract in which he had an obvious conflict of interest are, among other actions on the part of the defendant, sufficient basis for an inference

that the defendant failed to provide loyal and faithful services to LHRA. Fraudulent intent on the part of the defendant when he failed to provide his loyal and faithful services could have been inferred by the jury from, among other things, the substantial financial gains which he might receive in the process.

II. Construction Project

Defendant contends that the validity of the construction contracts with Howard Construction Company is controlled by § 2-419, Corp. & Ass'n., *Ann. Code of Md.*. Asserting that the government did not prove that the contracts were not fair and reasonable to the corporation when entered into, the defendant argues that the contracts were valid under § 2-419 and that he was entitled to the money he received pursuant to said contracts. Defendant also argues that the court was incorrect in its ruling that the contracts must have been both fair and reasonable to LHRA *and* entered into in good faith by the defendant in order for the contracts to be valid. Lastly, defendant argues that profits made by the defendant on the construction project may not be considered in determining whether the contracts were fair and reasonable to the corporation when they were executed.

Throughout the trial much of the legal argument, particularly that presented by the defendant, centered around § 2-419 which provides:

> "§ 2-419. Interested director transactions.
>
> (a). General rule — If subsection (b) of this section is complied with, a contract or other transaction between a corporation and any of its directors or between a corporation and any other

corporation, firm, or other entity in which any of its directors is a director or has a material financial interest is not void or voidable solely because of any one or more of the following:

(1) The common directorship or interest;

(2) The presence of the director at the meeting of the board or a committee of the board which authorizes, approves, or ratifies the contract or transaction; or

(3) The counting of the vote of the director for the authorization, approval, or ratification of the contract or transaction.

(b) Disclosure and ratification – Subsection (a) of this section applies if:

(1) The fact of the common directorship or interest is disclosed or known to:

(i) The board of directors or the committee, and the board or committee authorizes, approves or ratifies the contract or transacion by the affirmative vote of a majority of disinterested directors, even if the disinterested directors constitute less than a quorum; or

(ii) The stockholders entitled to vote, and the contract or transaction is authorized, approved, or ratified by a majority of the votes cast by the stockholders entitled to vote other than the votes of shares owned of record or beneficially by the interested director or corporation, firm, or other entity; or

(2) The contract or transaction is fair and reasonble to the corporation.

(c) Counting common or interested directors in determining quorum. Common or interested directors or the stock by them or by an interested corporation, firm or other entity may be counted in determining the presence of a quorum at a meeting of the board of directors or a committee of the board or at a meeting of the stockholders, as the case may be, at which the contract or transaction is authorized, approved or ratified.

(d) Burden of proof, fixing of compensation.

(1) If a contract or transaction is not authorized, approved or ratified in one of the ways provided for in subsection (b)(1) of this section, the person asserting the validity of the contract or transaction bears the burden of proving that the contract or transaction was fair and reasonable to the corporation at the time it was authorized, approved or ratified.

. . ."

On its face § 2-419 applies only to transactions in which a *director* has a "material financial interest" in the third party (in this case, Howard Construction Company) which is contracting with the corporation.

The transactions here at issue, which might loosely be termed the construction contracts of LHRA with HCC, are not one in which the directors of LHRA had a direct financial interest. Greta Shamy, the wife of the sole proprietor of HCC, had a "material financial interest" in HCC, however, in a vicarious way by virtue of her close relationship to her husband. A similar conclusion would

be reached in the case of Daniel Rizk, Joseph Shamy's father-in-law, and of Catherine Lonski, Joseph Shamy's sister. By virtue of this vicarious assignment of a "material financial interest" to Greta Shamy, Daniel Rizk and Catherine Lonski, the only directors of LHRA at the time of the approval of the HCC contract, the contracts must have initially met the test of § 2-419 in order to be valid.

Since Joseph Shamy was counsel to LHRA and its administrator at the time of the construction contracts, the transactions were clearly "interested officer" transactions as well as "vicariously interested director" transactions. The contracts, then, must have also passed muster under the applicable tests for transactions involving a corporation and an interested officer.

A. Interested Officer Transaction Test

There has been no codification in Maryland of the interested officer test. The fiduciary duty of an officer to provide his corporate employer his honest, loyal and faithful service appears to be identical to the duty owed to a corporation by its directors, *Maryland Metals v. Metzner,* 282 Md. 31, 37 (1978); *Chesapeake Construction Corp. v. Rodman,* 256 Md. 531 (1970). *See also, In Re Petrol Terminal Corporation,* 120 F. Supp. 867, 872 (D. Md. 1954); *Waller v. Waller,* 187 Md. 185 (1946); *Levin v. Levin,* 43 Md. App. 380, 390 (1978).

The defendant objects to the jury instruction which expounded on the requirements for the jury to find the construction contracts to be valid. Said instruction read as follows:

> ". . . When it comes to entering into a transaction between a corporation and an entity in

> which a director, employer, or attorney of the corporation has a financial interest, such a contract is not void or voidable if it is entered into in good faith (that is, primarily for the purpose of benefiting the corporation and not primarily the self interest of the director, officer, employee or attorney) *and* if it is fair and reasonable to the corporation . . .". (Emphasis supplied).

Defendant alleges that under § 2-419 Corp. & Ass'n Art., *Md. Ann. Code,* the contracts need only have been fair and reasonable to the corporation (LHRA) to be valid and that any subjective bad faith of the defendant did not effect the contracts' validity. The defendant's position erroneously is premised on the assumption that the only test to which the contracts were subject was that imposed by § 2-419. In view of the fact that the transactions here at issue were "interested officer" transactions, however, to which the standard of § 2-419 does not ordinarily apply, the basic premise of the defendants' argument fails.

An "interested officer" transaction must be both fair and reasonable to the corporation *and* entered into in good faith by the interested officer. *Chesapeake Construction Corp. v. Rodman, supra.* If the contracts of HCC with LHRA, being "interested officer" contracts, were either not entered into in good faith by the defendant or were not fair and reasonable to the LHRA, as a matter of law, they could not be valid under the facts of this case.[1]

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[1] In a proper case, disinterested directors, acting in good faith, could ratify an interested officer contract which had been entered into with the corporation by the corporate officer in bad faith. Such ratification would only be valid if the disinterested directors acted with full knowledge of all the pertinent facts.

The defendant has analogized the requirements of § 2-419, relating to an interested director transaction, to the non-statutory requirements for the validity of an interested officer transaction. Arguing that good faith of the director is not a pre-requisite under § 2-419 to the validity of an interested director transaction, the defendant asserts that good faith of the interested officer should not be required to validate an interested officer transaction.

Although § 2-419 does not expressly require good faith on the part of the director, there is a basis upon which to read a good faith requirement into the statute. Prior to the statutory change, there is no doubt that Maryland case law required both a fair and reasonable contract and good faith on the part of the interested director or officer in order for the transaction to be a valid one. *Chesapeake Construction Corporation v. Rodman,* 256 Md. 531 (1970). Additionally, under § 2-405.1 of the Corp. & Ass'n. Art. of the *Md. Ann. Code.,* a director is required to perform his duties in good faith at all times.

There exists no legislative history on § 2-419 except the comment (located at the end of § 2-419 in the Code) prepared by the State Department of Legislative Reference which describes § 2-419 as having been modeled after similar provisions in Delaware, New York and California Codes. While none of the those states have cases reported which discuss the matter directly, the courts of those states have read narrowly the changes in the law accomplished

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Defendant claims that Catherine Lonski, the defendant's sister, is a disinterested director who approved the contracts and therefore validated them. Assuming, *arguendo,* that she could be considered a disinterested director, there is no evidence that she knew all the pertinent facts, including the bad faith of the defendant. Furthermore, it is not clear that she even voted for the approval of the contracts. *See* GX55, GX56 and GX187.

by the statute which is the model for § 2-419. *See,* Bulbulia & Pinto, *Statutory Responses to Interested Directors' Transactions: A Watering Down of Fiduciary Duties,* 53 Notre Dame Lawyer, 201, 223 (1977). It would be in keeping with the precedent of the courts which have interpreted the model statute from which the Maryland Statute is derived to leave intact the good faith requirement previously imposed by the Maryland Courts (*Chesapeake Construction v. Rodman, supra*) prior to the enactment of the statute.[2]

The rationale for a good faith requirement still exists in the present Maryland – interested director – statutory law as it did in the prior case law represented by *Chesapeake Construction Corp. v. Rodman, supra.* To allow a corporate director or officer to benefit from a contract which he entered into in bad faith – breaching his duty to the corporation to provide loyal and faithful service to the corporation – would be to undermine the well developed law concerning the fiduciary relationship between a corporate director or officer and the corporation. *Maryland Metals v. Metzner,* 282 Md. 31, 37 (1978). ("This concern for the integrity of the employment relationship had led courts to establish a rule that demands of a corporate officer or employee an undivided and unselfish loyalty to the corporation.") There is no reason

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[2]*Compare, Savings and Loan Associations,* 62 Op. Atty. Gen. 804 (1977), in which the Maryland Attorney General concluded that § 2-405.1, Corp. & Ass'n Art., *Md. Ann. Code,* was not intended to abrogate the fiduciary duty imposed upon an officer or director not to usurp a corporate opportunity and that, therefore, an officer or director of a savings and loan association could not usurp a corporate opportunity, ". . . by subordinating the interest of the association to his own personal interest. . ." (at 812).

to believe that Maryland Legislature, in adopting the statute modeled after the Delaware and California statutes, intended to abrogate the duty of good faith in interested director or officer transactions. Therefore, the instruction given by the court to the jury that the construction contracts must have been both fair and reasonable to the corporation and entered into in good faith by the defendant was correct.[3]

Aside from the good faith requirement for the validation of the contracts with HCC, the government theory that the defendant deprived LHRA of his loyal services would, under the facts of this case, have been proven if the jury had concluded that the defendant had arranged for the contracts in bad faith. Under the jury instructions given, the jury could have concluded that the defendant defrauded Laurel Harness Racing Association (LHRA) either by fraudently taking money from the corporation under the pretext of invalid contracts *or* by fraudulently depriving the corporation of his loyal, faithful and disinterested services as an officer of the corporation. In other words, if Joseph Shamy acted in bad faith in entering into the contracts, then that alone constituted the active fraud of depriving the corporation of his loyal services as an officer of the corporation, notwithstanding the validity or

[3]During the trial, the parties seemed to have assumed that the provisions of § 2-419 governed the question of whether the construction contracts were valid. As previously noted the case law in Maryland has treated the fiduciary duties of corporate employees and directors as identical. Assuming, however, that § 2-419 imposes a different standard for the validation of an "interested director" than for an "interested officer" transaction, the transactions here were principally "interested officer" transactions. Under the standards of *Chesapeake Construction Corp. v. Rodman, supra,* the "interested officer" transactions must be entered into in good faith by the officer *and* must be fair and reasonable to the corporation.

invalidity of the construction contracts under otherwise applicable corporate law.

III. Fairness and Reasonableness of the Contracts

Another attack by the defendant on the verdict of the jury is based on the alleged insufficient evidence tending to show that the contracts were not fair and reasonable to LHRA. As noted above the court views the law to be, and so instructed the jury, that the HCC contracts in order to be valid has to be both entered into in good faith on the part of Mr. Shamy and fair and reasonable to LHRA. If either the element of Shamy's good faith or of the fairness and reasonableness of the contracts were proven by the government to be missing, the contracts could not be considered valid.

The court instructed the jury that in order for it to convict the defendant, it had to find fraudulent intent on the part of Mr. Shamy in causing the contracts to be entered into and went on to state that "[i]f Mr. Shamy *was acting in good faith,* dealing fairly with Laurel and not securing undue rewards, then there would be no intent to defraud." The jury, in finding Mr. Shamy guilty, clearly had to conclude that he was not acting in good faith. But, if the jury so found, then the contracts could not have been valid even if they had been objectively fair and reasonable to the corporation. Under the circumstances, therefore, a determination of the fairness and reasonableness of the contracts is irrelevant to the validity of the verdict since the contracts would have been invalid even if they had been fair and reasonable.

Much of the argument on this motion by the defendant has centered round the use of the amount of "after-the-fact profits" made on the construction project to show the

fairness and reasonableness of the contracts *at the* time at which they were entered into.

The cases cited by the defendant stand for the general proposition that the fairness and reasonableness of the contract should be determined as of the time the contract was entered into and that the reasonableness test measures the fairness of what the corporation receives as the *quid pro quo* for what it pays, not what the interested party managed to make in the transaction. The court's instructions mirrored this general proposition of law. Even so, the court held that the amount of profits made by the related party can be circumstancial evidence of the transaction's fairness. While it is problematical whether the evidence of the profits standing by itself would have been enough to show the contracts to be unfair and unreasonable at the time they were entered into (the government produced no other evidence on this issue at trial), as pointed out in the text of this opinion, the determination of fairness and reasonableness of the contracts was unnecessary because (1) the jury had to find fraudulent intent in order to convict, (2) fraudulent intent meant the contracts were not entered into in good faith by Joseph Shamy, and (3) the absence of good faith invalidated the contracts.

An appropriate order has already been entered.

/s/ James R. Miller, Jr.
JAMES R. MILLER, JR.
United States District Judge

Date: March 21, 1980

APPENDIX F

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
UNITED STATES OF AMERICA

v.

JOSEPH E. SHAMY
Defendant No. 1

JUDGMENT AND COMMITMENT ORDER

In the presence of the attorney for the government the defendant appeared in person on this date April 3, 1980.

__ WITHOUT COUNSEL. However the court advised defendant of right to counsel and asked whether defendant desired to have counsel appointed by the court and the defendant thereupon waived assistance of counsel.

X WITH COUNSEL R. Stan Mortenson, Esquire (Retained).

There being a JURY verdict of

__ NOT GUILTY. Defendant is discharged.

X GUILTY as to each of Counts Nos. 1, 3, 6, 7, 10, 12 and 13.

Defendant has been convicted as charged of the offense(s) of (Counts Nos. 1, 3 and 10) U.S.C., Title 18, Sections 1341 & 2 – Mail Fraud; Aiding and Abetting. (Counts Nos. 6, 7 and 12) U.S.C., Title 18, Sections 1341 & 2 – Fraud by Wire; Aiding and Abetting. (Count No. 13) U.S.C., Title 18, 1961 et seq. & 2 – Racketeering Activities; Aiding and Abetting.

The court asked whether defendant had anything to say why judgment should not be pronounced. Because no suf-

ficient cause to the contrary was shown, or appeared to the court, the court adjudged the defendant guilty as charged and convicted and ordered that: The defendant is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for a period of Four (4) Years as to each of Counts Nos. 1, 3, 6, 7, 10, 12 and 13; said terms of imprisonment imposed to run concurrently with each other, making a total term of Four (4) Years imprisonment.

IT IS FURTHER ADJUDGED that the Defendant pay a fine of One Thousand Dollars ($1,000.00) as to each of Counts Nos. 1, 3, 6, 7, 10, and 12; and a fine of Twenty Five Thousand Dollars ($25,000.00) as to Count No. 13; plus Costs; said fines to be cumulative, making a total fine of Thirty One Thousand Dollars ($31,000.00).

U.S. COSTS: $1,871.30

UPON ORAL ORDER OF THE COURT, COUNT NO. 4 WAS DISMISSED.

UPON ORAL MOTION OF DEFENDANT FOR JUDGMENT OF ACQUITTAL AS TO EACH OF COUNTS NOS. 2, 5, 8, 9 and 11, THE COURT GRANTED SAID MOTION, AND A JUDGMENT OF ACQUITTAL IS ENTERED AS TO EACH OF COUNTS NOS. 2, 5, 8, 9 and 11..

The court orders commitment to the custody of the Attorney General and recommends,

/s/ U.S. District Judge JAMES R. MILLER, JR.
Date April 3, 1980.

CERTIFIED AS A TRUE COPY ON
THIS DATE APRIL 11, 1980
By /s/ Charlotte Crawford
Deputy

APPENDIX G

Relevant Statutory Provisions:

18 U.S.C.§ 1341.

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

18 U.S.C.§ 1343.

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false of fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose

of executing such scheme or artifice, shall be fined not more than $1,000 or imprisoned not more than five years, or both. Addred July 16, 1952, c. 879,§ 18(a), 66 Stat. 722, and amended July 11, 1956, c. 561, 70 Stat. 523.

Opposition

Office - Supreme Court, U.S.
FILED
FEB 3 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-815

In the Supreme Court of the United States

OCTOBER TERM, 1981

JOSEPH E. SHAMY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

REX E. LEE
Solicitor General

D. LOWELL JENSEN
Assistant Attorney General

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QUESTIONS PRESENTED

1. Whether the court of appeals was required to remand for a new trial when it found that the district court had charged the jury improperly by including, at petitioner's insistence, an instruction on an irrelevant issue, but also found that the jury otherwise had been properly instructed as to all elements of the crimes for which petitioner had been indicted and that the unnecessary instruction had been distinctly favorable to petitioner.

2. Whether the court of appeals correctly held that a Maryland statute that specifies the requirements for the enforceability of contracts between fiduciaries of a corporation could not insulate petitioner's conduct from prosecution under the federal mail and wire fraud statutes, 18 U.S.C. 1341 and 1343.

3. Whether petitioner's statements to private auditors were obtained in violation of his Fifth Amendment privilege against self-incrimination.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) is reported at 656 F. 2d 951. The memorandum opinions of the district court (Pet. App. 21a-30a, 33a-45a) are not reported.

JURISDICTION

The judgment of the court of appeals was entered on August 13, 1981. A petition for rehearing was denied on September 25, 1981 (Pet. App. 19a). The petition for a writ of certiorari was filed on October 30, 1981. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

After a jury trial in the United States District Court for the District of Maryland, petitioner was convicted on three counts of mail fraud (18 U.S.C. 1341), three counts of wire fraud (18 U.S.C. 1343), and one count of conducting an

enterprise through a pattern of racketeering activity (18 U.S.C. 1962).[1] He was sentenced to four years' imprisonment on each count to run concurrently and was fined $31,000. The court of appeals affirmed (Pet. App. 1a-17a).

1. The evidence, as summarized in the opinion of the court of appeals, showed that in March 1976, petitioner helped arrange the purchase by members of his family of a majority of the shares of the Laurel Harness Racing Association, a corporation which conducted harness horse racing meets in Laurel, Maryland (Pet. App. 2a, 4a).[2] The board of directors of the corporation consisted of petitioner's father-in-law, wife and sister. Petitioner was not a director, officer or stockholder, but he served as Laurel's general counsel (*id.* at 4a).

The corporation's primary problem was that the raceway's clubhouse and track were in serious disrepair and thus required extensive improvements. Indeed, the Maryland Racing Commission gave notice that Laurel's racing days would be revoked if improvements were not begun in two months and finished within a year (Pet. App. 4a-5a).

Petitioner assumed the responsibility of general contractor for the improvements, but he created an elaborate scheme to conceal his involvement. He opened a bank account in the name of Howard Construction Company and forged a construction contract between Howard and Laurel (Pet. App. 5a). The contract called for $3,600,000 to be paid to Howard from the construction of the improvements at the track. In July 1976, petitioner had Laurel issue

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[1]Six additional mail and wire fraud counts were dismissed by the district court. Petitioner's co-defendants—his wife Greta and his father-in-law, Daniel Rizk—were granted mid-trial severances.

[2]In May 1975, petitioner and two associates purchased Laurel from the Hutchinson family (Pet. App. 3a). Because of personal financial set-backs, petitioner sold his interest in November 1975 (*ibid.*).

two checks to Howard, even though Howard had not yet incurred any expenses on the project.

Three months later, Laurel's accountants, Ernst & Ernst (now Ernst & Whinney), began an audit, as required by the Maryland Racing Commission (Md. Ann. Code art. 78B, § 10 (1975)), for the 12-month period ending on September 30, 1976. The two July checks for $325,000 to Howard prompted Ernst & Ernst to request to see the construction contracts (Pet. App. 6a). Petitioner provided Ernst & Ernst with copies of the contracts in January 1977; he said that the payments were for site work, even though the site work was not begun until well after the checks were issued (*ibid.*). The auditors subsequently learned that petitioner might have an interest in the Howard Construction Company. They asked petitioner about this and he gave varying responses. His first answer was that he was general counsel for Howard. Later, petitioner and his father-in-law signed a statement for the audit report that asserted that petitioner was general counsel for both Laurel and Howard, but was a stockholder in neither and had no other function in either corporation. On two other occasions, petitioner said that the Howard Construction Company was really owned and operated by an individual named Joe Sage (*ibid.*).[3]

The auditors also asked for a list of the subcontractors on the construction project. Petitioner provided a list that included, *inter alia*, BBI Contractors and Advance Equipment Company, neither of which had been on any earlier list of contractors (Pet. App. 6a). Moreover, approximately $150,000 that was listed as paid to BBI had been sent instead to Commercial Trading Company for part payment of a mortgage on a parcel of property petitioner owned in New

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[3]In reality, Sage functioned as a coordinator for the subcontractors on the construction project (Pet. App. 5a).

Jersey. And funds that were sent to Advance Equipment Company were deposited in the account of Advance Car Wash and then paid to petitioner (*id.* at 6a-7a).[4]

The auditors then sought independent confirmation from the subcontractors concerning the work they performed. Petitioner returned unsigned confirmation letters from BBI and Advance Equipment. When the auditors were not satisfied with his claim that the letters had been sent to Laurel, petitioner gave the auditors the name of a person to contact at each company. The purported BBI employee actually worked for a New Jersey corporation owned by petitioner who had been instructed to answer his telephone by saying "BBI." The auditors could not locate the second individual (Pet. App. 7a).

Petitioner continued to deny any relationship with BBI or Advance Equipment until the eve of a March 8, 1978 meeting with Ernst & Ernst and the Attorney General of Maryland. Two days before this meeting, petitioner finally admitted that he indeed had a connection with the two contractors (Pet. App. 7a). At the March 8 meeting, petitioner's wife agreed to produce the books and records of BBI and Advance Equipment. Five days later, however, petitioner and his wife refused to produce them for Ernst & Ernst (*id.* at 7a-8a).

Records submitted by petitioner to Ernst & Ernst stated that Howard Construction had a total overhead of $497,917 and a profit of $403,432. The overhead figure, however, included funds disbursed to BBI and Advance Equipment for non-existent work. The evidence showed that Howard's true overhead could not have been more than $57,000. Petitioner's actual profits through Howard in fact exceeded

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[4]Petitioner also drew $170,000 from Laurel on August 1, 1977. He used all but $10,000 to make an interest payment on a personal loan (Pet. App. 9a).

$1,200,000 (Pet. App. 8a-9a).[5] At the May 1978 Laurel stockholders' meeting, the minority stockholders finally learned that petitioner owned Howard Construction, BBI and Advance Equipment (*id.* at 10a).

2. Prior to and during trial, petitioner's defense rested on Md. Corp. & Ass'ns Code Ann. § 2-419 (Cum. Supp. 1981).[6] That section provides that a contract between a corporation and an interested party is not void solely because of that common interest if the contract is ratified by a majority of "disinterested directors," or if the contract is "fair and reasonable." Petitioner's theory was that he could not be convicted of mail or wire fraud unless the government proved beyond a reasonable doubt that his contract with Laurel was unfair or unreasonable at the time the contract was entered into. This conclusion was based on petitioner's view that federal law could not criminalize conduct that was expressly declared permissible under state law.

The district court accepted petitioner's basic theory that state law could insulate petitioner from a mail and wire fraud conviction, but rejected his construction of the Maryland statute. The court instructed the jury that it could not find that petitioner was involved in a scheme to defraud

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[5]The opinion printed in petitioner's appendix (Pet. App. 9a) inadvertently dropped a zero from the amount of petitioner's profits. For the true amount, see *United States* v. *Shamy*, 656 F. 2d 951, 955 (4th Cir. 1981).

[6]Although § 2-419 does not appear to apply to petitioner as general counsel for the corporation, the district court found that Maryland courts had applied the provision to contracts with other employees and fiduciaries (Pet. App. 11a n.2).

Prior to trial, petitioner also moved to suppress evidence that he had made available to the auditors as part of their investigation. The district court denied the motion on the ground that petitioner as an individual officer of a corporation could not assert self-incrimination or any other privilege on behalf of the corporation.

unless it found either that the contract was unfair or unreasonable at the time it was executed or that petitioner entered into it in bad faith (Pet. App. 11a).

The court of appeals affirmed petitioner's convictions (Pet. App. 17a). Initially, it noted that the district court properly interpreted Maryland law as requiring petitioner to have entered into the contracts in "good faith" (*id.* at 11a). It reasoned that the general requirement of good faith imposed on all activities of corporate fiduciaries in Md. Corp. & Assn's Code Ann. § 2-405 (1975) was not altered by § 2-419. The court went on to hold that the district court had unnecessarily instructed the jury with regard to the Maryland statutes because "[e]ven had it wished to do so, Maryland could not have immunized conduct violative of the federal mail and wire fraud statutes * * *" (Pet. App. 13a). Notwithstanding this error, the court of appeals concluded that a new trial was unnecessary because the jury had been properly instructed as to all elements of the offenses for which petitioner had been indicted and the additional instruction requiring a finding of bad faith was "more favorable to [petitioner] that his entitlement" (*ibid.*).[7]

ARGUMENT

1. Petitioner contends (Pet. 12-16) that the decision below conflicts with this Court's decisions in *Dunn* v. *United States*, 442 U.S. 100, 106-107 (1979), and *Cole* v. *Arkansas*, 333 U.S. 196 (1948), that an appellate court cannot affirm a conviction on a theory that was not presented to the trial court. Petitioner's reliance on these decisions is misplaced. This Court in both *Dunn* and *Cole* found

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[7]The court of appeals also rejected petitioner's claim that the introduction of evidence obtained from him through Ernst & Ernst violated his Fifth Amendment privilege against self-incrimination (Pet. App. 15a-17a). It did not adopt the district court's conclusion that petitioner was only asserting the corporation's rights, but instead found that the disclosures had not been compelled (*id.* at 16a).

that the Due Process Clause was violated when the reviewing courts avoided deciding whether the government's case was adequate to prove the claims in the indictment. In each case the reviewing court found that the evidence sustained a theory of criminal liability different from that presented to the jury at trial. The essence of these holdings is that "the most basic notions of due process" are offended if a conviction is sustained "on a charge that was neither alleged in an indictment nor presented to a jury at trial * * *." *Dunn* v. *United States, supra*, 442 U.S. at 106.

The indictment in this case clearly alleged that petitioner used the mails and telephone to carry on a scheme involving a sham general contractor and sham subcontractors in order to defraud Laurel of his services and of its money. The jury was instructed properly that it had to find beyond a reasonable doubt that petitioner engaged in this scheme to defraud Laurel, and by its verdict, the jury so found. The court of appeals affirmed that determination. Thus, the decision below is in no way inconsistent with *Dunn* or *Cole*.

Petitioner argues (Pet. 13, 15 n.5), in attempting to extend *Dunn* and *Cole*, that a new trial should have been granted because the district court's decision that Maryland law was applicable affected his trial strategy. Thus, petitioner asserts that if he had known in advance what the court of appeals was going to state in its opinion, then he would have testified at trial and would have presented character witnesses to prove that he lacked fraudulent intent. This factbound claim is based wholly on speculation, and is contradicted by the record. There is no reason to assume that advance knowledge of the ruling in question would have affected petitioner's trial strategy. At trial, petitioner argued consistently that "good faith" was not a requirement of the Maryland statute. When the district court rejected that argument at the close of the government's case and with ample opportunity for petitioner to

react to the decision, he still chose not to testify or present character witnesses to explain his good faith (Pet. App. 14a).

In the court of appeals, petitioner claimed that the district court had misled him into believing that good faith was not an issue and that this affected his trial strategy. The court of appeals rejected this argument with reasoning that applies equally to petitioner's claim here (Pet. App. 14a):

> The prosecution's theory was clearly stated in the indictment, and, except for statements during skirmishes over the admission of particular items of evidence, the prosecution adhered to that theory. There was no surprise or confusion affecting the fairness of the trial. The most that can be said is that defense counsel suffered the disappointment of not entirely succeeding in transferring the battle to ground of his own choosing.

2. Petitioner next argues (Pet. 16-19) that the court below was incorrect in finding that Md. Corp. & Ass'ns Code Ann. § 2-419 (Cum. Supp. 1981) was irrelevant in this federal mail and wire fraud prosecution. This issue, which turns on the proper interpretation of a state statute, clearly raises no issue warranting review by this Court.

Petitioner maintains (Pet. 17) that his conduct was valid under the Maryland statute. But § 2-419 merely says that a contract between a corporation and an interested party is not necessarily void because of the mutuality of interest between the parties. As the court of appeals recognized (Pet. App. 12a), § 2-419 does not address other grounds for invalidation of such a contract, such as petitioner's misrepresentation and deliberate concealment of his self-dealing transactions. Accordingly, petitioner is simply wrong in urging that § 2-419 validates his conduct. Because the statute does not purport to legalize petitioner's action, this case

does not properly raise the more general issue posed by petitioner (Pet. 18) concerning the relationship between state law regulating business transactions and federal mail and wire fraud prosecutions.

3. Finally, petitioner argues (Pet. 19-22) that his statements to Laurel's auditors were obtained in violation of his privilege against self-incrimination. The short answer to this claim is that petitioner in no way was compelled to give the information or to waive his privilege against self-incrimination.

This Court "has never on any ground, personal privacy included, applied the Fifth Amendment to prevent the otherwise proper acquisition or use of evidence which, in the Court's view, did not involve compelled testimonial self-incrimination of some sort." *Fisher* v. *United States*, 425 U.S. 391, 399 (1976). The court of appeals found that the Maryland Racing Commission did not "compel" petitioner to disclose this evidence under pain of losing a valuable economic benefit as in *Spevack* v. *Klein*, 385 U.S. 511 (1967), and *Garrity* v. *New Jersey*, 385 U.S. 493 (1967). Instead, the Commission merely had a rule requiring a full audit and a general power to suspend a license for failure to comply with the rules. Md. Ann. Code art. 78B, § 10 (1975). There was no actual threat or even a clear mandate in the statute for suspension of Laurel's license based on petitioner's failure to supply personal information. As the First Circuit observed in an analogous case: "We do not think that the subjective fears of defendants as to what might happen if he refused to answer * * * are sufficient to bring him within *Garrity's* cloak of protection." *United States* v. *Indorato*, 628 F. 2d 711, 716, cert. denied, 449 U.S. 1016 (1980). See also *United States* v. *Solomon*, 509 F. 2d 863, 866, 871-872 (2d Cir. 1975); *United States ex rel. Sanney* v. *Montanye*, 500 F. 2d 411, 414-415 (2d Cir. 1974). The

determination by the court of appeals that there was no compulsion in this case does not conflict with any decision of this Court or any other court of appeals.[8]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE
Solicitor General

D. LOWELL JENSEN
Assistant Attorney General

LOUIS M. FISCHER
Attorney

FEBRUARY 1982

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[8]Petitioner is also wrong in his claim (Pet. 21) that the auditors were acting as agents of the FBI. As the court below found (Pet. App. 16a), the auditors' inquiry concerning petitioner's relationship to Howard Construction Company was not prompted by the FBI, but rather by the auditors' independent responsibility to undertake a full examination of Laurel's affairs. In fact, the FBI acquired information from Ernst & Ernst only through a grand jury subpoena (Pet. App. 9a).

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Petitioner's Reply Brief

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No. 81-815

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Petitioner,

v.

UNITED STATES OF AMERICA.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF[1]

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1. The government acknowledges that "[p]rior to and during trial, petitioner's defense rested on Md. Corp. & Ass'ns Code Ann. § 2-419 (Cum. Supp. 1981)." Br. in Opp.

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[1]The government's statement of facts takes a great deal of liberty with the evidence presented at trial. For example, the government refers to a "forged" construction contract between Howard and Laurel. Br. in Opp. at 2. Even the court of appeals, in referring to this contract, found it appropriate to footnote the fact that the elderly witness who testified concerning the signature on the contract "admitted telling his lawyer that he was not sure he had never given [petitioner] authorization [to sign it], but that his lawyer told him that it was too late to change his testimony already provided the grand jury." Pet. App. at 5a n.1. Despite several flaws in the government's factual presentation, we do not present any restatement here since the government has not contended that the contractual price was unfair to the corporation or its shareholders, or that the contracts were not fully performed. Beyond that, the underlying facts are irrelevant to the legal issues presented.

at 5. Petitioner's contention is that when the court of appeals sustained his conviction by finding that the district court erred in applying the Maryland statute, the appellate court altered the entire legal theory upon which the case was tried and presented to the jury. At that point, the court of appeals should have remanded the case for a new trial consistent with its different interpretation of the law. This was required under *Dunn v. United States,* 442 U.S. 100 (1979) and *Cole v. Arkansas,* 333 U.S. 196 (1948).

The government presents two arguments to justify the lower court's failure to remand for a new trial.[2] First, the government suggests that petitioner is seeking to extend *Dunn* and *Cole* because, as the government reads those decisions, there is a due process violation only "if a convic-

[2]The government seeks to minimize the significance of the lower court's action by recasting one of the "Questions Presented" as "whether the court of appeals was required to remand for a new trial when it found that the district court had charged the jury improperly by including, at petitioner's insistence, an instruction on an irrelevant issue . . . ." Br. in Opp. I. This unfairly presents the issue to be considered. The jury instruction involved a statutory provision which was not only directly relevant but comprised the core of petitioner's defense. The court of appeals' ruling made the issue irrelevant only as to any retrial, but did not and could not reduce the importance of the question as it affected both the defense strategy and the jury's deliberation in the case from which petitioner appealed. We note further that under *Dunn*, even a similarity between the proof necessary under the trial theory and that required under the appellate theory does not ameliorate the due process violation: there is a violation even where "no glaring distinction" exists between the two theories. *Dunn v. United States, supra*, 442 U.S. at 107.

As far as "petitioner's insistence" is concerned, petitioner asked for a ruling concerning the statute at the outset of the trial and it was the district judge who informed both the government and the defendant that the Maryland statute was fully applicable to the case. Tr. 4733, and Pet. App. 27a-29a. This put the government on notice that if the contract was valid under state law, the defendant was lawfully entitled to the money he received and could not be guilty of fraudulent conduct.

tion is sustained 'on a charge that was neither alleged in an indictment nor presented to a jury at trial.' " Br. in Opp. at 7. In the government's view, the indictment here charged a mail and wire fraud scheme, and the general jury instructions contained the standard elements for finding a violation of those statutes. In other words, the government proposes to restrict the protections of *Dunn* and *Cole* to situations in which the theory upon which the court of appeals affirms a conviction differs only from the indictment or the general jury instructions, not when it differs from the entire theory upon which the case was tried.

Dunn and *Cole* are not so limited. In *Cole*, the technical discrepancy was between, on the one hand, the particular section of the statute charged in the indictment and referred to in the jury instruction and, on the other hand, the section cited by the appellate court. This Court stated that "[i]t is as much a violation of due process to send an accused to prison following a conviction *on a charge on which he was never tried* as it would be to convict him upon a charge that was never made." *Cole v. Arkansas, supra,* 333 U.S. at 201 (emphasis added). The Court in *Dunn* expanded this concept. It noted that "[w]hile there was no variance between the indictment and proof at trial, *there was a discrepancy between the basis on which the jury rendered its verdict and that on which the Court of Appeals sustained petitioner's conviction." Dunn v. United States, supra,* 442 U.S. at 106 (emphasis added). This Court in both cases was very explicit. Defendants are "entitled to have the validity of their convictions appraised on consideration of the case *as it was tried* and *as the issues were determined in the trial court." Cole v. Arkansas, supra,* 333 U.S. at 202 (emphasis added). In petitioner's case, there is no dispute – and the government does not

intimate otherwise — that the appellate court failed to evaluate petitioner's conviction on consideration of the case either "as it was tried" or "as the issues were determined in the trial court." This failure places the decision below in direct conflict with both *Dunn* and *Cole*.

The government also contends that petitioner has not demonstrated any actual prejudice as a result of the appellate court's ruling. Br. in Opp. at 7-8. Petitioner's statement that, absent the trial court's erroneous interpretation of the law he would have presented a substantial defense, including his own testimony and that of others, is described by the government as "a factbound claim . . . based wholly on speculation . . . and contradicted by the record." Br in Opp. at 7. In the government's words: "There is no reason to assume that advance knowledge of the [appellate court's] ruling . . . [which supplanted the trial judge's specific interpretation of the applicable law] would have affected petitioner's trial strategy." *Id.* Careful examination of this argument makes it apparent that the government is actually contending that if the court of appeals sustains a conviction on consideration of a case other than "as it was tried" or "as the issues were determined in the trial court," it is then the defendant's burden to persuade this Court that his defense or the jury's verdict would have been different.

The government's fundamental contention is flawed in several respects. First, in *Dunn* and *Cole*, this Court held that the court of appeals could not, consistent with the Constitution, alter the basis upon which the case was tried and the conviction obtained, "simply because the same result would likely obtain on retrial." *Dunn v. United States, supra*, 442 U.S. at 107. In short, speculation as to what might have happened is simply irrelevant. Second, the government does not attempt to demonstrate a lack of

prejudice to petitioner arising from the court of appeals' ruling, but instead merely asks this Court to shift the burden of proving prejudice to petitioner. In fact, there is an irrebuttable presumption of prejudice inherent in any *Dunn* violation of due process, as this Court recognized in *Dunn* when it held that the due process defect was not cured by the fact that "the same result would likely obtain on retrial." *Id.*

Finally, contrary to the government's contentions, there are very strong reasons to assume prejudice in this case. The jury deliberated five days and convicted petitioner only after the trial judge delivered an *Allen*-type instruction. This obviously delicate balance between acquittal and conviction existed even though petitioner rested without presenting any evidence. In view of the fact that petitioner testified on four occasions before the grand jury, the government cannot legitimately suggest that the record demonstrates that he would not have taken the stand on his own behalf had he known that the court of appeals would subsequently overrule the trial judge with respect to the cornerstone of his defense.[3]

In summary, the government has agreed that petitioner's entire defense – both prior to and during trial – was

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[3]The government's suggestion that this Court should now, in effect, penalize petitioner for his decision not to take the stand or present a defense under the situation as it existed at trial is unfair. Petitioner and his counsel were entitled to rely upon the trial court's interpretation of the law and make deliberate choices concerning how to proceed in light of those rulings. Simply because the court of appeals reversed the lower court on the most fundamental of those rulings, petitioner cannot be faulted for the course he chose, nor should he be penalized for it. To do so makes a mockery of the defendant's constitutional right to the informed assistance of counsel in defending a criminal case. *See United States v. Hinton*, 631 F.2d 769, 780 (D.C. Cir. 1980).

based on an interpretation of the applicable law with which the district court agreed. The government does not dispute that the court of appeals sustained the conviction on consideration of the case other than "as it was tried" or "as the issues were determined by the trial court." And the government has not even attempted to demonstrate that this alteration of the theory of the case did not prejudice petitioner. Instead, the government only seeks to shift that burden to petitioner – a tactic not condoned by *Dunn, Cole* or any other applicable case. Under these circumstances, it is clear that petitioner's conviction cannot be upheld without granting him a new trial. Accordingly, a writ of certiorari should be granted, the decision of the court of appeals reversed, and the case remanded for a new trial.

2. The court of appeals held that despite a state statute specifically defining the acceptable standards for contracts between a corporation and its fiduciaries, the federal government can impose upon that state's fiduciaries – through a prosecution under the mail and wire fraud statutes – a less precise standard of conduct defined by general notions of "public policy" and "moral uprightness." According to the appellate court: "Maryland could not have immunized conduct violative of the federal mail and wire fraud statutes from prosecution in a federal court." Pet. App. 13a.[4]

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[4]The government expressly recognizes that this was the court's holding. The government's brief states, Br. in Opp. at 6 (emphasis added):

> Initially, [the court] noted that the district court properly interpreted Maryland law as requiring petitioner to have entered into the contracts in "good faith" ([Pet. App.] at 11a). . . . The court went on *to hold* that the district court had unnecessarily instructed the jury with regard to the Maryland statutes because "[e]ven had it wished to do so,

The government makes no attempt to minimize the significance of this holding. Indeed, it cannot be minimized. The provision which Maryland adopted in 1976 to govern interested-party contracts between its corporations and their fiduciaries is based on the Model Business Corporation Act § 41,[5] and has been adopted in its basic form in at least 30 states.[6] Thus, the effect of the court of appeals' holding is that any corporate director or officer in these states who enters into an entirely "fair and reasonable" transaction (the Model Code standard) with his or her corporation, but fails to make full disclosure (an omission excused under § 41(c) of the Model Code if the fair and reasonable standard is met) can be prosecuted in federal court if the wires or mails are used. Any doubt as to the breadth of the court's ruling was laid to rest when it stated (Pet. App. 13a):

> Maryland could not have immunized conduct violative of the federal mail and wire fraud statutes * * *" (Pet. App. 13a).

[5]Section 41 of the Model Business Corporation Act is attached hereto as Appendix A.

[6]Ariz. Rev. Stat. Ann.§ 10-041; Cal. Corp. Code § 310 (West); Colo. Rev. Stat. § 7-5-114.5 (Supp.); Del. Code Ann. tit. 8, § 144; Fla. Stat. § 607.124; Ga. Code § 22-716; Idaho Code § 30-1-41 (Supp.); Ind. Code § 23-1-10-6; Iowa Code Ann. § 496A.34 (West Supp.); Kan. Stat. Ann. § 17-6304; Ky. Rev. Stat. Ann. § 271A.205 (Baldwin); La. Rev. Stat. Ann. § 12:84 (West); Me. Rev. Stat. Ann. tit. 13-A, § 717; Mich. Comp. Laws Ann. § 21.200(545); Neb. Rev. Stat. § 21-2040.01; Nev. Rev. Stat. § 78.140; N.J. Stat. Ann. § 14A:6-8; N.Y. Bus. Corp. Law § 713 (McKinney Supp.); N.C. Gen. Stat. § 55-30; Ohio Rev. Code Ann. § 1701.60 (Page); Or. Rev. Stat. § 57.265; Pa. Stat. Ann. tit. 15, § 1409.1 (Purdon Supp.); R.I. Gen. Laws § 7-1.1-37.1 (Supp.); S.C. Code § 33-13-160; Tenn. Code Ann. § 48-816 (Supp.); Vt. Stat. Ann. tit. 11, § 1888; Va. Code § 13.1-39.1 (Supp.); W. Va. Code § 31-1-25 (Supp.); Wis. Stat. Ann. § 180.355 (West Supp.); Wyo. Stat. §17-1-136.1 (Supp.).

> Any breach of a fiduciary duty by a corporate employee effected in part by the use of the mails may be a violation of the federal mail fraud statute, at least when accompanied by concealment or a failure to disclose relevant and material information.

Whether federal fraud statutes can be expanded to cover mere breaches of fiduciary duty is an issue of increasing concern. *See generaliy* Coffee, *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics,* 19 Am. Cr. L. Rev. 117 (1981)[7] The question squarely raised here is whether federal fraud statutes operate wholly independently of – indeed, supersede – what a state legislature determines by statute to constitute "public policy" and "accepted standards of moral uprightness" for fiduciaries within the state.

The government suggests that this Court need not reach this significant question because, in its view, § 2-419 does not cover contracts when there has been any concealment or misrepresentations by a fiduciary. Br. in Opp. at 8-9. This argument misreads both the statute and the court of appeals' decision. First, it is clear on the face of the statute that disclosure on the part of the interested party is only one basis on which to validate an interested-party contract; the contract may also be supported – despite the failure to disclose his interest – if it is "fair and reasonable to the corporation." *See* § 2-419(b)(2).

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[7]This article principally analyzes *United States v. Bronston,* 658 F.2d 920 (2d. Cir. 1981), *petition for cert. filed,* No. 81-1441 (Feb 1, 1982) in which the defendant was convicted of mail fraud for breaching the applicable standard for a fiduciary's conduct. In this case, petitioner – unlike the defendant in *Bronston* – *met* the explicitly applicable standard of conduct, and was still convicted under the federal fraud statutes.

Moreover, the district court ruled that the government never proved that the contract was not properly ratified by the disinterested members of the Board, another basis for validating the contract. Pet. App. at 26a.

Second, and more significant here, the district court explicitly found the statute applicable, and the court of appeals implicitly accepted that conclusion by ruling more broadly that Maryland "could not have immunized" petitioner's conduct from federal prosecution in any event. Pet. App. at 13a. Indeed, if the court of appeals had determined that petitioner's contract with the corporation fell outside the scope of the Maryland statute, there would have been no need for it to rule that Maryland could not statutorily immunize conduct otherwise violative of federal fraud law. Thus petitioner had presented the court of appeals with three bases for finding that the contracts met the requirements of § 2-419, including the fact that the contracts were properly ratified by the Board of Directors under § (b)(1)(i) of the statute. The court, after opining only on the implied good faith issue, avoided having to confront the other validating provisions by holding instead that the effect of the federal fraud statutes was not impaired by any Maryland law legitimizing the underlying contractual transaction. In other words, in order for the court to rule as it did on the broader question, it necessarily had to accept the fact that petitioner's contract fell within the scope of the statute. Otherwise the lower court would have been required to rule on petitioner's alternative bases for validating the contract under the statute. Consequently, the issue properly presented here is *not* one of correct state law interpretation, but instead the broader question of a state's ability to adopt standards of fiduciary conduct conforming to modern concepts, without its fiduciaries being subject to federal prosecution at the

behest of a prosecutor desiring to impose a more ill-defined standard of "moral uprightness" upon the fiduciary.

3. Respecting petitioner's Fifth Amendment claim, the government states that "[t]he court of appeals found that the Maryland Racing Commission did not 'compel' petitioner to disclose this evidence under pain of losing a valuable economic benefit as in *Spevack v. Klein*, 385 U.S. 511 (1967), and *Garrity v. New Jersey*, 385 U.S. 493 (1967)." Br. in Opp. at 9. In fact, the court of appeals did not hold that there was *no* governmental compulsion. It held that the audit requirement did not "constitute *impermissible* governmental compulsion." Pet. App. at 16a (emphasis added). Citing *Gardner v. Broderick*, 392 U.S. 273 (1968), the court of appeals based its conclusion as to the "permissibility" of the compulsion solely on the fact that no waiver of immunity was sought. Pet. App. at 16a. The court failed to address either *Spevack* or *Garrity*, neither of which involved a waiver. Like this case, both *Spevack* and *Garrity* involved governmental compulsion to testify, under the threatened loss of a substantial economic benefit.

Aside from misreading the opinion below, the government departs from the record in arguing that the state-approved auditors who questioned petitioner concerning his business were not acting as agents of the FBI (Br. in Opp. at 10 n.8), and further misinterprets the court's opinion by stating that the court "found" that "the auditors' inquiry concerning petitioner's relationship to Howard Construction Company was not prompted by the FBI, but rather by the auditors' independent responsibility to undertake a full examination of Laurel's affairs." *Id.* With respect to the relationship between the auditors and the FBI, the record is undisputed that the Maryland Attorney

General and Racing Commission instructed the Ernst & Ernst auditors to cooperate with the FBI in its investigation. Tr. Sept. 19, 1979, at 123, 176-77. Thereafter, the FBI told the auditors not to take notes of their meetings with the FBI nor to inform anyone at Laurel of the FBI's interest. *Id.* at 141-43. Ernst & Ernst complied with both instructions. *Id.* at 30, 91-92, 141-42. Moreover, the record demonstrated that the auditors' cooperation with the FBI did, in fact, affect the scope of their audit in that the auditors conducted an office desk search, an "extraordinary" procedure that was not part of their normal practice. *Id.* at 28-29, 36, 113. Finally, the subpoena described in the government's brief as having been the only mechanism for transmitting information from the auditors to the FBI was, in fact, solicited by the auditors for their own protection. *Id.* at 55-56, 58, 125. Indeed, the FBI consulted Ernst & Ernst about the wording the auditors preferred in the subpoena before delivering it. *Id.* at 60.

Under the circumstances, the issue clearly presented for this Court is the constitutionality, under the Fifth Amendment, of using statements made by a defendant to state-approved auditors cooperating with the FBI at the specific instruction of the state attorney general where those statements are made during the course of an audit required by state law as a condition for continued business licensing.

CONCLUSION

For the reasons stated herein, and in the petition, we request that the Court grant a writ of certiorari to review the decision of the court of appeals.

Respectfully submitted,

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APPENDIX A

Model Business Corporation Act:

§ 41. Director Conflicts of Interest

No contract or other transaction between a corporation and one or more of its directors or any other corporation, firm, association or entity in which one or more of its directors are directors or officers or are financially interested, shall be either void or voidable because of such relationship or interest or because such director or directors are present at the meeting of the board of directors or a committee thereof which authorizes, approves or ratifies such contract or transaction or because his or their votes are counted for such purpose, if:

(a) the fact of such relationship or interest is disclosed or known to the board of directors or committee which authorizes, approves or ratifies the contract or transaction by a vote or consent sufficient for the purpose without counting the votes or consents of such interested directors; or

(b) the fact of such relationship or interest is disclosed or known to the shareholders entitled to vote and they authorize, approve or ratify such contract or transaction by vote or written consent; or

(c) the contract or transaction is fair and reasonable to the corporation.

Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or a committee thereof which authorizes, approves or ratifies such contract or transaction.